AUDIT EXPECTATION-PERFORMANCE GAP IN THE UNITED KINGDOM IN 1999 AND COMPARISON WITH THE GAP IN NEW ZEALAND IN 1989 AND IN 1999

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Published by
The Institute of Chartered Accountants of Scotland
Edinburgh

First published 2004
The Institute of Chartered Accountants of Scotland

ISBN 1-904574-04-1

Printed and bound in Great Britain
by Antony Rowe Ltd

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The Research Committee is grateful to all those who participate in the refereeing process.

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Foreword

For many years external auditors have been subjected to increasing amounts of criticism and litigation and the collapse of Enron and WorldCom in the US, and the subsequent worldwide disintegration of their external auditors Arthur Andersen, has demonstrated the fragility of professional reputations. The most damaging criticisms are those that suggest that an auditing firm has failed the society in which it works. So it is vital to understand what society expects of auditors. Of course it may be that society's expectations of auditors are unreasonable, or fall outside the framework to which auditors must work, but if so auditors need to explain why it is impossible to meet them. The aim must be to ensure that performance matches up to legitimate expectations, and if not to explain why.

Understanding the audit expectations gap, the gap between what society expects of auditors and its perception of their performance, is therefore of great importance to the auditing profession. Expectations change too and it is important to understand the nature of those changes. This research project builds on earlier work that Brenda Porter carried out in New Zealand in 1989 to study the structure, composition and extent of what that earlier research described as the 'audit expectations-performance gap'. The new research repeated the earlier study ten years on, using the same title, this time in both New Zealand and in the UK.

The research involved a questionnaire survey of four broad interest groups including auditors, auditees and audit beneficiaries both inside and outside the financial community. The respondents were asked whether particular responsibilities were existing responsibilities of auditors, if they thought it was an existing responsibility how well it was performed, and whether it should be a responsibility of auditors. The identification of what are 'existing responsibilities' for the questionnaire and the subsequent analysis was carried out by the researchers themselves, and so could be open to different interpretations. It is not essential to agree with the framework of 'existing responsibilities' used to derive great benefit from the results of the study.

The researchers divide the audit expectations gap into two main elements, what they call the reasonableness gap and the performance gap. The reasonableness gap represents the gap between what society expects of auditors and what auditors can reasonably be expected to accomplish. The performance gap represents the gap between what society can reasonably expect of auditors and what it perceives that they actually deliver. The researchers then sub-divide the performance gap into two elements – the deficient standards gap and the deficient performance gap. The deficient standards gap is the gap between the responsibilities that society reasonably expects auditors to perform and auditors' actual responsibilities, as set down by statute, case law and auditing standards. The deficient performance gap is the gap between the expected standard of performance of auditors carrying out these responsibilities and auditors' actual performance of these responsibilities.

The researchers then analysed the responses to their questionnaire to calculate the size of these gaps in the UK in 1999 and in New Zealand in 1999 and 1989. They found that the extent of the audit expectation-performance gap in the UK and New Zealand in 1999 is very similar although the contribution of the different components to the gap differs quite significantly between the two countries. As far as New Zealand alone was concerned, the researchers found that the composition of the audit expectation-performance gap has changed significantly over the decade from 1989 to 1999 and that while auditors' performance of their responsibilities has improved so that the performance gap has narrowed, society's expectations of auditors have increased to a level that more than offsets this improvement. Indeed, the researchers found that the set of expectations driving the reasonableness gap is the most rapidly expanding element of the audit expectation-performance gap. The researchers suggest that this is a consequence of a number of significant and unexpected company collapses in both the UK and New Zealand in recent years, in some cases accompanied by or resulting from misconduct by senior officers or employees of the company.

They argue that public pressure on government and regulators has resulted in demands that companies become more accountable and implement measures to improve corporate governance. Auditors are seen as potentially key players in this regulatory response and as such, society's expectations of them have increased dramatically. The main problem for auditors and the profession going forward is that the public lacks real knowledge about what auditors actually do and so has unrealistic expectations of auditors' responsibilities and the means they have of discharging them. This creates a real need for the profession to seek an informed debate on the development of the auditors' role in society whilst explaining why some of the criticism directed towards auditors is unfounded. The report suggests that the introduction of the long form audit report, which highlights succinctly for the reader a number of significant limitations in an audit, has done little to eliminate the expectation gap. Indeed the report suggests that public ignorance of the auditors' role and the audit function is as high as it ever was, even among the groups expected to have some interest in the audit process.

The researchers suggest that if society's expectations of auditors and perceptions of auditor's performance could be more closely aligned, it is likely that criticism of auditors and litigation against them could be reduced and confidence in the profession would improve. Their report is intended to help stimulate that alignment process.

The Research Committee of The Institute of Chartered Accountants of Scotland has been happy to sponsor this project and is pleased that the research is now becoming available at a time when there is public interest and debate over the auditing profession and its future. The Research Committee hopes that this project will be seen as a valuable contribution to the development of the auditing profession.

Nigel Macdonald
Convener
Research Committee
June 2004

Acknowledgements

The authors acknowledge with thanks the financial support provided for this research by the Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants of New Zealand.

They also acknowledge and thank the many people who assisted with the development of the survey instrument and identification of the survey sample. In particular, the authors express their warmest gratitude to the following people who generously gave their time, thoughts and expertise to assist with the research:

Warren Allen	Partner, Ernst & Young (Wellington, NZ)
Philip Ashton	Partner, PricewaterhouseCoopers (London)
Professor Vivien Beattie	The Institute of Chartered Accountants of Scotland and the University of Stirling
Mollie Bickerstaff	Partner, KPMG (London)
Gill Bolton	Technical Development Adviser, The Institute of Internal Auditors (IIA)
Tony Cornelius	Pannell Kerr Forster (UK)
Sir David Dobson	The Institute of Investment Management and Research (IIMR)
Martin Evans	Director of Audit Policy and Appointments, Audit Commission
Tim Fairhall	Partner, PricewaterhouseCoopers (Wellington, NZ)
Mark Fisher	The Institute of Internal Auditors (IIA)
Professor Phil Gendall	Head of the Marketing Department, Massey University, Palmerston North, New Zealand
Kim Hurst	Mazars Neville Russell (London)
Ann Lamb	Assistant Director, Research, The Institute of Chartered Accountants of Scotland
Derek Lemay	HLB Kidsons (London)
Professor Ian Percy OBE	Chairman, Accounts Commission for Scotland
David Prince	Chief Executive, District Audit
Martin Sinclair	Assistant Auditor General, The National Audit Office (NAO)
Harris Wells	The Accounts Commission
Martyn White	HSBC (Burnley, Lancashire)

Early drafts of the research findings attracted responses from many quarters. The authors are grateful to all those who provided written or verbal comments.

Conducting a mail survey on the scale involved in this project entails an enormous amount of administrative work. For the UK portion of the research, much of this was located at the University of Central Lancashire where Catherine Gowthorpe was Principal Lecturer for most of the duration of the project. Dorothy Bridges, the project's research assistant, was unfailingly calm, thorough and efficient. Philip Baugh and Anne-Marie Schumacher, both of the University of Central Lancashire, and Sheila Hart and Dennis Gound, of Cranfield School of Management, provided valuable practical and administrative help and support.

Finally, the authors thank the many individuals who took time to complete the questionnaire. Without their help the research reported here would not have been possible.

Executive Summary

Since the early 1970s, external auditors have increasingly been the target of criticism and litigation. This reached an unprecedented level in 2001/2002 following the unheralded collapse of the giant corporates Enron and WorldCom and their auditor, Arthur Andersen.

Criticism of auditors, and litigation against them may result from auditors failing to meet society's expectations of them. It may be that society's expectations are unreasonable, or that society's expectations are reasonable but that auditors' existing legal and professional requirements do not fulfil these expectations. Alternatively, it may be that auditors do not perform their existing responsibilities to a satisfactory standard. Whatever the cause of the gap between society's expectations of auditors and its perception of auditors' performance (termed 'the audit expectation-performance gap'), the resultant dissatisfaction with auditors' performance serves to undermine confidence in the auditing profession and the external audit function.

Research objectives and methodology

In 1989 Porter, recognising the adverse consequences of the audit expectation-performance gap, conducted research in New Zealand (NZ) to ascertain the structure, composition and extent of the gap. Towards the end of 1999, the authors of this report undertook two interlinked studies to investigate the audit expectation-performance gap in the United Kingdom (UK) and NZ, respectively – studies that essentially replicated Porter's 1989 research. More specifically, the objectives of the current research were:

- to investigate the structure, composition and extent of the audit expectation-performance gap in the UK and NZ in 1999;
- to compare the structure, composition and extent of the gap in the two countries and to identify, and tentatively explain, any differences that could be discerned (a cross-cultural study);
- to compare the structure, composition and extent of the gap in the UK and NZ, respectively, in 1999 with that in NZ in 1989 (a longitudinal study).

Although the legal, social and economic environments of the UK and NZ are not identical, the researchers consider that they are sufficiently similar to allow meaningful comparisons of the audit expectation-performance gap in the two countries to be made.

The research was conducted by means of a questionnaire that was mailed to 1,610 randomly selected members of four broad interest groups (auditors, auditees, and audit beneficiaries from inside, and from outside, the financial community) in the UK and 1,534 members of these groups in NZ. The survey instrument in the two countries was identical apart from minor modifications necessitated by differences in terminology, institutions and regulations. The questionnaire contained a list of 51 suggested responsibilities of auditors and respondents were asked to indicate, in respect of each:

- whether the responsibility was, or was not, an existing responsibility of auditors, or whether they were not sure;
- if the responsibility was an existing responsibility of auditors, how well it was performed;
- whether the responsibility should be a responsibility of auditors.

This research report details the results of the research, focusing in particular on the findings of the UK portion of the project. However, in order to permit a comparison of the structure, composition and extent of the audit expectation-performance gap in the UK in 1999 with that in NZ in 1999 and in 1989, the results of the NZ portion of the research are also reported in summary form.

Definition of the audit expectation-performance gap

For the purposes of the research, the definition of the audit expectation-performance gap proposed by Porter (1993) is adopted. This gap is defined as that between: (i) society's expectations of auditors; and (ii) auditors' performance as perceived by society. This gap comprises two major components:

1. the *'reasonableness gap'* – the gap between what society expects of auditors and what auditors can reasonably be expected to accomplish;

2. the *'performance gap'* – the gap between what society can reasonably expect of auditors and what it perceives they deliver. This may be subdivided into:

   (a) the *'deficient standards gap'* – the gap between the responsibilities society reasonably expects auditors to perform and auditors' actual responsibilities, as defined by statute, case law, regulations and professional promulgations; and

   (b) the *'deficient performance gap'* – the gap between the expected standard of performance of auditors' carrying out these responsibilities and auditors' actual performance of these duties.

Research findings

Structure, composition and extent of the audit expectation-performance gap

The extent of the audit expectation-performance gap in the UK and NZ in 1999, is remarkably similar with a difference of less than 2%. However, the contribution of the gap's components differs quite markedly in the two countries: in the UK, the reasonableness, deficient standards and deficient performance gaps constitute 50%, 42% and 8%, respectively, of the audit expectation-performance gap; in NZ, the comparative proportions were 41%, 53% and 6%. Similarly, while in the UK the reasonableness, deficient standards and deficient performance gaps comprise 23, 10 and 7 actual or suggested responsibilities of auditors, respectively, the equivalent components of the audit expectation-performance gap in NZ consist of 18, 14 and 5 responsibilities.

In 1989 in NZ the reasonableness, deficient standards and deficient performance gaps contributed 31%, 58% and 11%, respectively, to the audit expectation-performance gap and the gaps comprised 9, 10 and 5 responsibilities, respectively. Thus, over the decade from 1989 to 1999, the composition of the audit expectation-performance gap has changed significantly. It appears that auditors' performance of their responsibilities has improved but that the narrowing of the deficient performance and deficient standards gaps has been more than offset by an increase in society's unreasonable expectations of auditors and a resultant widening of the reasonableness gap.

Reasonableness gap

As may be seen from above, in 1999 the reasonableness gap constituted half (50%) of the audit expectation-performance gap in the UK and a significant proportion (41%) of the gap in NZ and is the most rapidly expanding component of the audit expectation-performance gap.

Since 1989, in both the UK and NZ, significant companies have collapsed unexpectedly – frequently accompanied by revelations of misconduct by their senior officials – and, as a result, the government, regulators, and the public have demanded that companies be made more accountable and that they implement measures to secure responsible corporate governance. Auditors have been identified as potential key players in these domains and, as a consequence, society's expectations of auditors in these regards have increased significantly. However the greater incidence of corporate scandals in the UK compared with NZ, has resulted in UK society having greater expectations of auditors playing a role in the corporate governance and corporate accountability arenas. Hence, the reasonableness gap is wider in the UK than in NZ.

Nevertheless, the reasonableness gap was comprised of some responsibilities that were found to not be cost-effective for auditors to perform. Thus, society's expectations of auditors, particularly in the UK, outstrip what is reasonable to expect of them. This may, at least in part, be a function of society's lack of knowledge about the audit function and the work of auditors. Each of the four broad interest groups (including the auditor group) in both the UK and NZ displayed a 'knowledge gap' with respect to auditors' existing responsibilities – a gap that was wider the greater the distance of the group from the audit function. In the UK and NZ, 52% and 59%, respectively, of audit beneficiaries from outside the financial community were in error or uncertain about auditors' existing responsibilities. This compared with 38% and 39% of audit beneficiaries from the financial community, 31% and 27% of auditees, and 18% and 20% of auditors in the UK and NZ respectively. The extent of the lack of knowledge about auditors' existing responsibilities should be of concern to the auditing profession as it indicates, *inter alia,* that criticism of auditors is likely to be misinformed and that the chance of informed debate about the role of auditors in society is not high.

The impact of society's lack of knowledge about auditors' responsibilities on the reasonableness gap was reflected in the fact that in both the UK and NZ around 40% of the society group (that is, all non-auditor respondents) signified that they expected auditors to *guarantee* that audited financial statements were *completely accurate* and that an auditee whose financial statements received an unqualified audit report was *financially sound*. It was also pertinent to note that all of the responsibilities that featured as elements of the reasonableness gap in NZ in 1989 reappeared in 1999 in this component of the audit expectation-performance gap in both the UK and NZ. This should be of concern to the auditing profession in both countries as it suggests that, despite the introduction of the long-form audit report since 1989, no progress has been made in educating auditors' interest groups about the audit function and the responsibilities that it is reasonable to expect of auditors.

Deficient standards gap

In 1999, the deficient standards gap – the gap constituted by responsibilities reasonably expected but not currently required of auditors – accounted for more than half (53%) of the audit expectation-performance gap in NZ and a significant proportion (42%) of the gap in the UK. The difference in the extent of the deficient standards gap in the UK and NZ resulted primarily from three responsibilities that contributed to the deficient standards gap in NZ and therefore not a current requirement, but were actual responsibilities of auditors in the UK. (Two of these related to auditors reporting matters of concern discovered during an audit to an appropriate authority when it was in the public interest to do so; the other matter was reporting on the reliability of information presented in the auditee's annual report about its directors' and senior executives' remuneration policy and record.) Once allowance was made for these, the extent and composition of the deficient standards gap in the UK and NZ in 1999 were strikingly similar. Most of the responsibilities comprising this component of the audit expectation-performance gap related to auditors' disclosure of information in the audit report or to an appropriate authority about matters of concern (in particular, fraud or other illegal acts) discovered during an audit. Other responsibilities included reporting in the audit report on the effectiveness of the auditee's internal financial controls, the reasonableness of financial forecasts included in the annual report and reporting to the auditee's directors on the adequacy of the company's risk management procedures.

Deficient performance gap

The deficient performance gap relates to the existing responsibilities of auditors that are perceived by society to be performed deficiently. This was the smallest component of the audit expectation-performance gap in both the UK and NZ and also narrowed markedly between 1989 and 1999. (In 1989 in NZ, the deficient performance gap constituted 11% of the audit expectation-performance gap; in 1999 it contributed 8% of the gap in the UK and 6% in NZ.) This narrowing of the gap can largely be attributed to the introduction of more effectual monitoring of auditors' performance by the professional bodies in both the UK[1] and NZ (accompanied by the imposition of sanctions for deficient performance), and a revision of the 'Going concern' auditing standard. In 1989, the society group in NZ adjudged auditors' performance of their responsibility 'to disclose in the audit report doubts about the continued existence of the auditee' to be particularly unsatisfactory (37% of the group signified that auditors perform this responsibility poorly). In 1999, following the introduction of a revised auditing standard, which sets out auditors' responsibilities in this regard more clearly and stringently, auditors' performance of the responsibility was perceived by society to have improved significantly with only 23% of the society group in the UK, and 20% of the group in NZ, indicating that auditors perform the responsibility poorly.

Notwithstanding the narrowing of the deficient performance gap between 1989 and 1999, the same five responsibilities that constituted the gap in NZ in 1989 reappeared as elements of the gap in both the UK and NZ in 1999. Additionally, in the UK, two other responsibilities (that are not existing responsibilities of auditors in NZ[2]) contributed to the deficient performance gap. These were auditors reporting privately to an appropriate authority the theft of auditee assets, or other illegal acts by the auditee's directors or senior management.

As might be anticipated, in both the UK and NZ, audit beneficiaries from the financial community – the group most likely to rely on the outcome of auditors' work – was the group that was least satisfied with auditors' performance of their existing responsibilities. Auditees are the next most critical, followed by audit beneficiaries from outside the financial community. The auditor group was the least dissatisfied with the performance of their existing responsibilities.

Narrowing the audit expectation-performance gap

If society's expectations of auditors, and auditors' performance, were more closely aligned (that is, the audit expectation-performance gap were narrowed), it is highly probable that criticism of auditors and litigation against them, would decrease and confidence in the auditing profession and the work that it does would increase. The research findings detailed in this report provide an insight into the structure and composition of the audit expectation-performance gap and how it has changed over the decade from 1989 to 1999. From these findings, five measures have been identified that could be implemented to narrow this expectations gap.

1. *Strengthening the monitoring of auditors' performance*

The apparent success of the monitoring of auditors' performance in effecting improved performance, suggests that this activity should be continued and strengthened, for example, through less leniency being granted where breaches of auditing or other professional standards are found, and more stringent sanctions being imposed when sub-standard performance is encountered.

2. *Improving the quality control in audit firms*

The monitoring of auditors' performance has helped to effect improved performance, but to ensure that all auditing practitioners perform their work to a satisfactory standard on every audit, effective quality control systems within audit firms are needed. In the UK in September 2000, the Auditing Practices Board issued a revised Statement of Auditing Standards (SAS) 240: *Quality control for audit work*. This provides clear and exacting guidance on the quality control policy and processes audit firms are to implement.

A revised International Auditing Standard 220: *Quality control for audit engagements*, which closely follows the UK's SAS 240, is in the course of development and, once finalised, will be incorporated, in all its essential requirements, in New Zealand's auditing standards.

3. *Enhancing the education of auditing practitioners*

The research findings suggest that the enhanced education of auditors is required. It was noted that auditors were found to have a 'knowledge gap' in respect of their existing responsibilities. It is therefore suggested that further education, possibly through compulsory professional development sessions, be required of all existing, as well as trainee, auditors about their responsibilities under statute and case law, *quasi*-governmental regulations and professional promulgations, and also about the standard of work that is required.

4. Introducing new auditing standards

In order to narrow the deficient standards gap, auditing standards need to embrace the responsibilities that can reasonably be expected of auditors but are not yet required. As noted most of these involved auditors reporting either in the audit report, or to an appropriate authority, matters of concern such as fraud and/or other illegal acts encountered during an audit. Other areas for consideration include: examining and reporting on the effectiveness of auditees' internal financial controls; the reasonableness of financial forecasts included in annual reports; the adequacy of risk management procedures; and in the case of listed company auditees, the compliance with all corporate governance requirements.

If the auditing profession were willing to broaden its responsibilities through the issue of new and/or revised auditing standards to embrace these duties that can reasonably be expected of auditors, the audit expectation-performance gap would be narrowed significantly. However, it seems that the willingness of the profession to accept any extended responsibilities is hampered by concerns about the perceived potential increase in exposure to legal liability rather than encouraged by the potential benefits to be gained from better meeting society's expectations and be thereby enhancing the value of the audit function in society.

5. Educating society about the audit function and the work of the auditor

From the research findings, especially those in respect of the reasonableness gap, it is evident that society, in both the UK and NZ, needs educating about the audit function and what auditors can reasonably be expected to achieve. However, given the apparent ineffectiveness of the long-form audit report introduced in both the UK and NZ during the early 1990s to educate financial statement users about the respective responsibilities of an auditee's directors and auditors for its financial statements, the level of assurance provided by the audit report, and the key elements of the audit process[3], it is not easy to identify the means by which education of society at large may be accomplished. One possible means is to use the opportunity afforded by an infamous fraud and/or unexpected corporate failure that reaches the media headlines to explain the audit function and the work of auditors. At present, when untoward company events occur, journalists, or others seeking to lay the blame at someone's door seem to raise uninformed questions (or allegations) about the relevant auditors' apparent failure to fulfil what the journalists or others presume to be their duties. The profession's usual response in such circumstances appears to be a formal and rather technical statement, by a senior representative, rebuffing the allegations. Such a statement does little to correct society's misconceptions about the audit function or to restore confidence in the profession. Such occasions could be used to explain, in a non-technical, easily understandable language, the auditors' role in those particular circumstances – and placing those circumstances in the broader context of the audit function and the role and responsibilities of auditors in general.

An alternative, and perhaps more effective way to educate society, is to seek opportunities to educate influential journalists, formally and informally, about the audit function and the work of auditors. If they begin to understand the work of the profession better, they may report adverse events affecting auditors in a more informed and less sensational manner.

Conclusion: Auditors' role in narrowing the audit expectation-performance gap

Limperg (1933, reproduced in Limperg Instituut 1985) observed that auditors have a dual responsibility: not to arouse 'in the sensible layman' greater expectations than can be fulfilled by the work done, and to carry out the work in a manner that does not betray the expectations evoked. Limperg's analysis highlights the fact that, if auditors fail to identify society's expectations of them, or to recognise the extent to which they meet (or, more pertinently, fail to meet) those expectations, then not only will they be subject to criticism and litigation but also, if the failure persists, society's confidence in the audit function will be undermined and the audit function, and the auditing profession, will be perceived to have no value.

The findings reported in this research report provide some insight into society's expectations of auditors, the perceived standard of their work, and the extent to which these expectations are not being fulfilled. The report also makes some recommendations on how auditors might better satisfy society's reasonable expectations of them and alter those that are not reasonable. Thus the research contributes in a meaningful way towards narrowing the audit expectation-performance gap. Once auditors' performance, as perceived by society, is better aligned with society's expectations of them, the liability and credibility crises facing auditors should abate and confidence in the auditing profession and the work that it does, should gradually be restored.

Endnotes:

[1] More strictly in the UK, the monitoring of auditors' performance has been introduced by the Recognised Supervisory Bodies with whom company auditors must be registered.

[2] These responsibilities contributed to the deficient standards gap in NZ in 1999.

[3] The ineffectiveness of the long-form audit report as a medium to educate financial statement users (who might be expected to read the audit report) about the audit function is witnessed by the fact that 33% of the financial community group in the UK and 43% of this group in NZ, signified that they expected auditors to guarantee that audited financial statements were completely accurate, and 43% of this group in both countries indicated that they expected auditors to guarantee that an auditee which received an unqualified audit report was financially sound. Additionally, 41% of the financial community group in the UK signalled that they expected auditors to prepare the auditee's financial statements.

CHAPTER ONE

INTRODUCTION

In the mid 1980s, Russell (amongst others) reported that external auditors in the Anglo-American world were facing 'a liability crisis and a credibility crisis' (Russell 1986, p.58). A review of the news media in more recent years reveals that these crises have not abated – rather they have worsened. Reports in the *Economist* (for example, February 1994, p.83), *Accountancy Age* (for example, Perry 2001a, 2001b) and the *Financial Times* (for example, Hill, Chaffin and Fidler), and also on websites such as those of the Securities and Exchange Commission (www.SEC.org) and *Accountancy Age* (www.accountancyage.com) reveal that litigation against auditors in the United States (US) and the United Kingdom (UK) has increased both in frequency and in size of claims. Similar reports may be found from many other parts of the world.

The widespread criticism of, and litigation against, auditors are a consequence of auditors not meeting society's[1] expectations of them (for example, Maccarrone 1993). This is particularly evident in relation to auditors not giving expected warning of a company's impending demise and/or of malpractice by senior company officers. As the recent Enron and WorldCom debacles bear witness, whenever a significant company collapses unexpectedly – especially when accompanied by fraud or other illegal or unscrupulous acts by senior executives – shareholders, creditors, suppliers, customers and others adversely affected by the company's unheralded failure raise the question 'Why didn't the auditors give proper warning?'.

The criticism of, and litigation against, auditors failing to meet society's expectations of them (or the expectations of groups within society) is clearly harmful to the individual auditors and/or audit firms concerned. However, the adverse consequences of auditors failing to fulfil the responsibilities expected of them – or failing to fulfil them to the expected standard – extend more widely: they result in undermining society's confidence in the audit profession as a whole and thus in the audit function. This, in turn, has serious undesirable ramifications for the well-being of national and international capital markets and the allocation of scarce economic resources.

In 1989, Porter, recognising the serious adverse consequences of the gap between society's expectations of auditors and its perception of auditors' performance (a gap she termed 'the audit expectation-performance gap') conducted research in New Zealand (NZ) to ascertain the nature, composition and extent of the gap. (This research is reported in Porter 1993). In 1999 Porter, Gowthorpe and Gendall[2] undertook research in the UK and NZ essentially replicating Porter's 1989 study. More specifically, the objectives of the research were as follows:

1. To investigate the structure, composition and extent of the audit expectation-performance gap in the UK and NZ in 1999.
2. To compare the structure, composition and extent of the audit expectation-performance gap in the UK and NZ, respectively, in 1999 and to identify and tentatively explain differences in the gaps (a cross-cultural study).
3. To compare the structure, composition and extent of the audit expectation-performance gap in the UK and NZ, respectively, in 1999 with that pertaining in NZ in 1989 and to identify and tentatively explain differences in the gaps existing a decade apart (a longitudinal study).

The primary objective of this report is to report the results of the research investigating the audit expectation-performance gap in the UK in 1999, which was financed and supported by The Institute of Chartered Accountants of Scotland (ICAS). However, summary results of the research conducted in NZ in both 1989 and 1999 are also reported in order to provide a basis for comparing the nature, composition and extent of the audit expectation-performance gap in the UK in 1999 with that pertaining in NZ in 1999 and 1989. Such comparison facilitates drawing some tentative conclusions about differences in the gap – and reasons therefore – in two countries (the UK and NZ) with similar legal, social and economic environments at the same point of time (1999) and a decade apart (1989-1999).

The remainder of this report is structured as follows. In chapter two, prior relevant literature is reviewed, the audit expectation-performance gap is defined and the structure of the gap is outlined. In chapter three, the methodology of the research is explained. Chapters four to six provide details of the results of the research, reporting in turn survey respondents' views about auditors' existing responsibilities, the standard of performance of those responsibilities, and the responsibilities auditors should perform. In chapter seven the key findings of the NZ component of the research are reported. In chapter eight, the UK and NZ findings of the research are compared and in chapter nine the results of the UK component of the present study are compared with the findings of the 1989 NZ research. Chapter ten sets out the significant conclusions of the research and recommends steps the auditing profession in the UK might take in order to narrow the audit expectation-performance gap.

Endnotes:

[1] In this report 'society' is defined to mean the population at large, inclusive of auditees and users of financial statements but exclusive of auditors. It thus coincides with all non-auditors. This accords with the meaning ascribed to the word by the Cohen Commission (CAR 1987). The Cohen Commission also used the term 'the public' with the same meaning.

[2] Porter and Gowthorpe and Porter and Gendall undertook the research in the UK and NZ respectively

CHAPTER TWO

REVIEW OF RELEVANT LITERATURE, DEFINITION AND STRUCTURE OF THE AUDIT EXPECTATION-PERFORMANCE GAP

The mismatch (or gap) between society's expectations of auditors and what auditors expect (or are perceived by society) to deliver is not new. Indeed, extant literature suggests that, although the term 'audit expectation gap' was not applied to the gap between society's (or financial statement users') and auditors' expectations of an audit until about 30 years ago, the existence of the gap was recognised more than 100 years ago.

This chapter provides a review of the audit expectation gap literature, a definition of the audit expectation–performance gap and an outline of the gap's structure. The difference between the terms 'audit expectation gap' and 'audit expectation–performance gap' is also explained.

Review of the audit expectation gap literature

The enduring theme throughout the audit expectation gap literature is the lack of a general or accepted understanding – both within the auditing profession and between the public and auditors – of what constitutes auditors' responsibilities. This theme is reflected in the observations of Chandler and Edwards (1996). They state:

> *Throughout the latter part of the nineteenth century the accounting profession had to deal with a level of public concern about the value of audits that is very familiar to us today. Then, as now, the criticism was provoked by the financial failure of well-known companies which had previously been held in high regard. Articles containing attacks on accountants and auditors appeared frequently in contemporary journals … and in the wider press. The debate on the manner in which the audit should be conducted, the methods to be used and the extent of the auditors' examination of the company's books and records reveals that there were expectation gaps within the profession itself concerning the proper conduct of an audit, as well as between public expectations and auditor performance* (p.12–13).

Of particular concern to some authorities in the late nineteenth century (as now!) was the public's unjustified faith in the ability of auditors to detect fraud (Chandler, Edwards and Anderson, 1993) – and the failure by the profession to enlighten the public on this issue. This is reflected in Harvey's (1897) assertion:

> *It is a mistake to imagine that a system of audit ensures absolutely the non-occurrence of a fraud, and the sooner the profession allows the public to understand this, the better it will be for them; but, unfortunately, the tendency of auditors is to give countenance to, rather than deny, their infallibility …* (as cited in Chandler *et al*, 1993, p 447).

The critical importance to the auditing profession of auditors influencing and meeting the public's expectations of them – and maintaining the public's confidence in their work – was highlighted by Limperg in essays written in 1932 and 1933. He stated:

> *The [audit] function is rooted in the confidence that society places in the effectiveness of the audit and in the opinion of the accountant. … if the confidence is betrayed, the function, too, is destroyed, since it becomes useless. … If the [audit] function is to achieve its objective, then no more confidence may be placed in its fulfilment than is justified by the work carried out and by the competence of the accountant, while conversely, the function must be fulfilled in a manner that justifies the confidence placed in its fulfilment.* (Limperg, as reproduced in Limperg Instituut 1985, p.16–17)

Limperg explained that the auditor has a dual responsibility: not to arouse 'in the sensible layman' greater expectations than can be fulfilled by the work done, and to carry out the work in a manner that does not betray the expectations evoked. His analysis underscores the fact that, if auditors fail to identify society's expectations of them and the extent to which they meet (or, more pertinently, fail to meet) those expectations, then not only will they be subject to criticism and litigation but also, if the failure persists, society's confidence in the audit function will be undermined – and, thus, the audit function (and the auditing profession) will be perceived to have no value.

Nearly sixty years after Limperg's essays were published, Fogarty, Heian and Knutson (1991) drew attention to the continued failure of the auditing profession to correct the public's misconceptions about what an audit can (or aims to) achieve. They noted:

> *Very little has been said of the time honoured contribution to the [expectation] gap by the profession itself. In constructing a reputation for exactitude and a goal of protecting the public, accounting has made a good portion of their own bed.* (p.213).

They also described conditions in the 1970s and 1980s as 'a perpetual state of crisis for public accounting' (p.201) – a situation that might be anticipated given the existence of the audit expectation-performance gap.

The most extreme potential consequence of litigation for a firm of auditors is involuntary cessation of activities. Until recently, the most notable example of a firm collapsing under the weight of litigation claims against it was that of the US firm of Laventhol and Horwath (the 7th largest audit firm in the US at the time) during the 1990s. However, the latest and most significant *cause célèbre* is the demise of the Enron Corporation and the consequent downfall of Andersen, one of the world's Big Five firms of auditors. The principal impact of litigation is likely to fall upon Andersen's practice in the US, but there is speculation that disappointed litigants will pursue actions against other parts of the worldwide Andersen partnership (Smith, 2002). The potential for cross-border litigation extends potential auditor liability still further and adds weight to the public perception of a profession in crisis.

Auditor credibility suffers with each successive, well-publicised case in which allegations of audit failure are made. The extent and prominence of the publicity accorded to the recent Enron case are unprecedented but many other cases have served to undermine the credibility of auditors and the audit function. Deficient performance by auditors was alleged for example in the Savings and Loans failures in the US (see Committe, 1994) and Briloff (2001) has documented a series of Accounting and Auditing Enforcement Releases (issued by the Securities and Exchange Commission in the US) directed against audit partners in respect of defective practice.

Although the UK has not suffered a case of the significance of Enron, there has been a steady drip-feed of criticism and public censure of the audit profession following corporate failure. The UK's Joint Disciplinary Scheme has censured auditors in a series of high profile cases including: Atlantic Computers (Spicer and Oppenheim), Astra Holdings (Stoy Hayward), London and Bishopsgate International Investment Management and two other companies 'associated with the late Mr Robert Maxwell' (Coopers & Lybrand), Polly Peck International (Stoy Hayward) and Resort Hotels (Coopers & Lybrand). Current investigations with implications for the auditors of the relevant companies include: BCCI (Price Waterhouse), Capital Corporation (Deloitte & Touche and Touche Ross), the Equitable Life Assurance Society (Ernst & Young) and The Independent Insurance Group (KPMG) (see www.castigator.org.uk). Another well-publicised case involving alleged deficient performance by auditors (Coopers & Lybrand and Deloitte & Touche) is that of Barings Bank (Perry 2001a, 2001b, 2002).

Given the potentially fatal impact of the audit expectation (or expectation-performance) gap on auditing as a valued function in society, it is not surprising that it has been the subject of research in many parts of the world. Studies have been conducted, for example, by Lee (1970) and Humphrey, Moizer and Turley (1992) in the UK; Liggio (1974), the Commission on Auditors' Responsibilities (Cohen Commission, 1978) and the National Commission on Fraudulent Financial Reporting (Treadway Commission, 1987) in the US; the Canadian Institute of Chartered Accountants (Adams Committee, 1978; Macdonald Commission, 1988) in Canada; Beck (1973), the Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia

(1994), and Monroe and Woodliff (1994) in Australia; Porter (1991, 1993) in New Zealand (NZ); Gloek and Jager (1993) in South Africa; Low, Foo and Koh (1988) in Singapore; Garcia Benau, Humphrey, Moizer and Turley (1993) in Spain; and Troberg and Viitanen (1999) in Finland.

In addition to the empirical studies cited above, there have been several explorations of theoretical dimensions of the audit expectation gap. Hooks (1991), for example, analysed the responses of the US auditing profession in the late 1980s to expectation gap issues, drawing upon taxonomic models of professionalism to categorise and explain the various regulatory responses to public concern about the audit. Fogarty *et al.* (1991), adopting the framework offered by institutional theory, analysed the responses of public accounting firms to the liability crisis they face. Their research proposes that the institutional environment of public accounting allows firms to produce 'symbolic displays' of concern about providing diligent service to the public while simultaneously, but on a different level, the firms are ruled by short-term profit maximising concerns. They conclude that the contradiction between the real and the symbolic produces irreconcilable tensions that facilitate successful legal actions against the firms. In another study, Gaa (1991) applied game theory to the expectations issue, characterising the controversy over the expectation gap as 'a political game between two contending parties [society and the auditor]' (p. 84). Looking at the expectation gap from the point of view of a solvable problem (or otherwise), Sikka, Puxty, Wilmott and Cooper (1998) contend that audit, as a social practice, is subject to constantly shifting meanings because the social context of auditing changes continuously through interaction and negotiation. They conclude that, because 'the meaning of audit cannot be fixed' (p.319), there is no prospect of eliminating the auditing expectation gap.

Although various empirical and theoretical studies of the audit expectation (or expectation-performance) gap and related issues have been conducted, until Porter's investigation of the gap in NZ in 1989, no in-depth analysis of the nature, composition and extent of the gap had been undertaken. An outcome of her research was a proposed definition of the audit expectation-performance gap and specification of its structure.

Definition and structure of the audit expectation-performance gap

Although a gap between society's expectations of auditors and auditors' performance has existed for more than 100 years, it appears that Liggio (1974) was the first to apply the term 'expectation gap' to auditing. He defined it as the difference between the levels of expected performance 'as envisioned by the independent accountant and by the user of financial statements' (p. 27).

In 1978, the definition was extended to some extent in the terms of reference of the Commission on Auditors' Responsibilities (CAR, the Cohen Commission, 1978). The Commission was charged 'to consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish' (p.xi). In each of these cases the gap is defined in terms of the difference in the expectations of auditors on the one hand and those of users of financial statements (Liggio) or the public (CAR) on the other as regards auditors responsibilities. This gap was (and is) referred to as the audit expectation (or expectations) gap.

However, these definitions of the gap do not embrace the notion that auditors may not accomplish 'expected performance' (Liggio) or what they 'can and reasonably should' (CAR). As Limperg explained, auditors' failure to meet society's expectations may be traced to two causes:

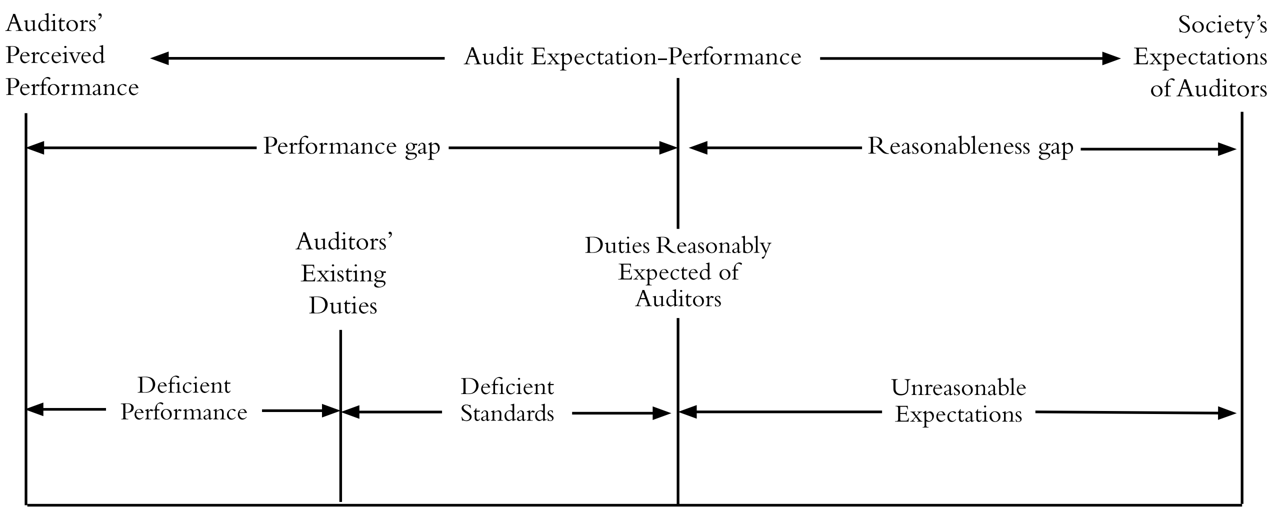
> *[T]here can be **exaggerated** confidence and a **shortcoming** in the fulfilment of the function. Initially this distinction seems perhaps to have little sense. For, if there is a shortcoming in the fulfilment of the function, then there is at the same time an 'exaggerated' confidence, ie. an expectation about the result of the work of the accountant that goes beyond what is justified by the manner in which the function is fulfilled. And, conversely, if there is an exaggerated expectation then also the work done falls short of the confidence placed in it. The effect of the accountant's work on the community will thus be the same … in both cases, the function has not been fulfilled. But the distinction serves a purpose in that it enables us to indicate the causes which have nullified the function; in the first case, the cause lies with the community or with the individual, whose expectations were excessive, while in the second case, the cause lies with the holder of the function who betrayed a legitimate confidence* (Limperg Instituut 1985, p. 17).

Porter (1993) extended the definitions of the audit expectation gap proposed by Liggio and the Cohen Commission and incorporated the distinction identified by Limperg. Adopting the title 'audit expectation-performance gap', she defined it as 'the gap between society's expectations of auditors and auditors' performance, as perceived by society' (p.50). She proposed that the gap comprises two major components, namely:

1. *the 'reasonableness gap'* – the gap between what society expects auditors to achieve and what they can reasonably be expected to accomplish (this coincides approximately with the Cohen Commission's definition of the gap);
2. *the 'performance gap'* – the gap between what society can reasonably expect auditors to accomplish and what society perceives they achieve. This component may be subdivided into:
   (a) *the 'deficient standards gap'* – the gap between the responsibilities that can reasonably be expected of auditors and auditors' existing responsibilities as defined by statute and case law, regulations and professional promulgations; and
   (b) *the 'deficient performance gap'* – the gap between the expected standard of performance of auditors' existing responsibilities and auditors' performance, as expected and perceived by society.

The structure of the audit expectation-performance gap is depicted in Figure 2.1.

Figure 2.1 The structure of the audit expectation-performance gap



The expectation gap in the United Kingdom in 1990 – a significant prior study

Before concluding this chapter reference should be made to a study by Humphrey, Moizer and Turley (1993) because of its apparent relevance to the research reported in this manuscript. Humphrey *et al* examined the audit expectation gap in the UK in 1990. Their research is, therefore, contemporaneous with Porter's (1993) study in NZ and consequently could, potentially, be comparable. In each case the research instrument was a detailed and complex questionnaire which was administered to a large and diverse group of survey participants. However, the two studies differ significantly in their objectives and thus in the questions asked.

The purpose of the Humphrey *et al* study is stated as being: 'to provide direct evidence of comparative differences between the views of practising auditors and those of the recipients of audit services'. By contrast, the key objective of Porter's (1993) study and that of the research detailed in this report is to identify and analyse the nature, composition and extent of the audit expectation-performance gap.

The Humphrey *et al* research elicited responses from auditors and five groups identified as users of audit services (accountants, finance directors, investment analysts, bankers and financial journalists) about, *inter alia*:

- the role auditors should perform in respect of a list of suggested obligations;
- the groups to whom auditors should be legally responsible;
- possible prohibitions and regulations on audit firms (principally relating to independence issues);
- the relative success of auditors in respect of activities such as communicating effectively, providing a useful service, and coping with risk and uncertainty. [The responses to this set of questions were compared with those (from the same respondents) about two other professional groups: solicitors and tax inspectors.]

(Details of the respondent groups and the survey instrument used for Porter's 1989 study and for the research reported here are provided in the next chapter).

Although the objective of Humphrey *et al's* (1993) and Porter's (1993) research differed and, as a consequence, the detail of the survey instrument and groups of survey participants differed, the general finding was the same, namely, that there was a wide (statistically significant) gap between the opinions of auditors and the beneficiaries of their services about various aspects of the audit function and auditors' responsibilities. Humphrey *et al.* also concluded that the responses to their questions regarding auditors', solicitors' and tax inspectors' success in performing certain activities suggested that the gap in the views of auditors and users of their services is not the consequence of a general bias against the professions.

Summary

In this chapter relevant extant literature has been reviewed and the audit expectation-performance gap has been defined and its structure outlined. Examination of the literature reveals that the gap has both an enduring existence and adverse consequences. Additionally, the numerous empirical studies of the audit expectation (or expectation-performance) gap that have been conducted in a wide range of countries, indicate that the gap is a matter of concern to the auditing profession in many parts of the world.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter reports the methodology of the empirical research. First the composition and selection of the survey sample is discussed and then details of the survey instrument are provided. As the objectives of the research included identifying and explaining differences in the audit expectation-performance gap in the UK and NZ in 1999 (a cross-cultural analysis) and comparing the audit expectation-performance gap in the UK and NZ, respectively, in 1999 with that pertaining in NZ in 1989 (a longitudinal analysis), the survey groups and instrument adopted for the UK study (and also for the NZ component of the research) were very similar to those adopted for the 1989 study in NZ.

Survey sample – respondent groups

The research was conducted by means of a mail survey. This method was selected as it facilitated ascertaining the opinions of representative samples of various groups in society[1] who are affected to a greater or lesser extent by the audit function, about the responsibilities[2] of external financial statement auditors and how these responsibilities are discharged.

Four broad interest groups were first identified, each having a distinct and different relationship with auditors and the audit function, namely:

- external auditors – the performers of external financial statement audits;
- auditees – subjects of external audits;
- audit beneficiaries from the financial community – direct beneficiaries of the audit function (as users of audited financial statements);
- audit beneficiaries from outside the financial community – indirect beneficiaries of the audit function (for example, as members of pension funds and/or as contributors to National or Local Government funds (*via* taxes) which invest in companies that are subject to audits).

Subgroups of each of the broad interest groups were then identified and samples of survey participants randomly selected from the subgroup populations. In November 1999, in the UK a total of 1,610, and in NZ a total of 1,534, questionnaires were mailed to named individuals. Details of the interest groups surveyed in the UK and their response rates are presented in Table 3.1. (Equivalent data for the NZ portion of the research is presented in Table 8.1 in Chapter 8.) As may be seen from Table 3.1, the overall usable response rate in the UK was 26%, ranging from 73% for the auditor group to 11% for the non-financial community group. Notwithstanding the disappointingly low response rate, the survey included two follow-ups to non-responses at intervals of approximately one month. The responses received from each of the initial and two subsequent mailings were reviewed for non-response bias but no differences in the responses were detected.

Survey instrument

Like the survey groups, for reasons noted above, the same survey instrument (with minor modifications to reflect institutional differences) was used in both the UK and NZ in 1999 and this was based on that used for the 1989 study in NZ. In addition to according with the research objectives, adoption of the 1989 survey instrument provided the advantage of ensuring that the current research was based on a survey instrument with proven success.

Table 3.1 Sample groups and response rates – UK 1999

Interest group	No. in survey	No. usable responses	% usable responses
Auditors			
Audit partners	100	72	72
Audit staff	100	74	74
Total	**200**	**146**	**73**
Auditees			
Chief Executives	100	23	23
Financial Directors	100	24	24
Non-Executive Directors	100	20	20
Internal auditors	100	34	34
Total	**400**	**101**	**25**
Audit beneficiaries: Financial community			
Stockbrokers	100	17	17
Financial analysts	100	28	28
Bankers – corporate lenders	100	35	35
Institutional Investors	30	9	30
Auditing/Accounting regulators	10	8	80
Auditing academics	20	9	45
Total	**360**	**106**	**29**
Audit beneficiaries: Non-financial community			
Solicitors	100	8	8
Financial Journalists	50	10	20
General public	500	54	11
Total	**650**	**72**	**11**
Combined totals	**1,610**	**425**	**26**

As may be seen from the questionnaire used in the UK in 1999, presented in Appendix A, Part 1 sought outline details of the respondents' professional profile and an indication of their general level of interest in financial statements and the auditor's report. Part 2 provided an integrated list of actual and potential responsibilities of auditors. These responsibilities were identified by reference to statute law, case law, *quasi*-government regulations, professional promulgations and the academic and professional auditing literature and also through consultation with senior audit partners in the Head Offices in both the UK and NZ of some of the 'Big 5' international firms of accountants. In addition to the 30 suggested responsibilities of auditors included in the 1989 questionnaire, 21 further responsibilities were listed. Eight of these arose from specifying the responsibilities in greater detail (for example, in relation to detecting and reporting theft of company assets); the other 13 represented suggested responsibilities for auditors in areas that have gained prominence during the past decade (for example, corporate governance, corporate social responsibility issues, and auditors' responsibility in relation to the auditee's entire annual report). In Appendix C, the 'additional' responsibilities arising from specifying the responsibilities in greater detail are shown in bold; those resulting from coverage of 'new' areas are shown in italics.

For each of the 51 suggested responsibilities of auditors listed in the questionnaire, survey participants were asked to indicate their response to three questions:

1. Is the responsibility an existing responsibility of auditors (according to the law, regulations, or professional promulgations)?
2. If the responsibility is an existing responsibility of auditors, how well is it performed?
3. Should the responsibility be a responsibility of auditors?

The questionnaire was pilot-tested in both the UK and NZ amongst representative samples of the four broad interest groups. In-depth interviews (lasting approximately one hour) were conducted with each member of the pilot test sample after they had completed the questionnaire. Their comments prompted minor modification to the survey instrument before it was finalised.

Coding and testing survey responses

For questions 1 and 3, the options 'yes', 'no', and 'not sure' were provided. These were coded +1, -1, and 0 respectively. Consequently, referring to Tables 4.1, 6.1 and 8.2 (in Chapters 4, 6 and 8, respectively), where the mean of a group's responses is positive, this signifies that the group considered that the responsibility in question is, or should be (as applicable), a responsibility of auditors. The converse applies where the mean of a group's responses is negative[3]. The absolute value of the mean (ranging from a possible ±100 to 0) indicates the extent to which the opinion is shared by members of the group. The closer the mean is to ±100, the greater the agreement of that group's opinion.

In relation to how well auditors perform their responsibilities, respondents were asked to select from the options 'poorly', 'adequately', 'well', and unable to judge'. These were coded 1, 2, 3, and 0, respectively. Thus, (referring to Tables 5.1 and 5.2 in Chapter 5 and Tables 8.3 and 8.4 in Chapter 8), if the mean of a group's responses in respect of a particular duty is less than 2.0, this suggests that members of the group (excluding those who were unable to judge) considered that auditors' performance of their duty is inadequate or unsatisfactory. However, judging performance as adequate, or otherwise, tends to involve a range rather than a point measurement. Hence, while recognising the arbitrary nature of any number selected to distinguish between adequate and inadequate performance, for the purposes of the research 1.9 was adopted as the point of differentiation. This measure was supported by an additional test to identify sub-standard performance of particular duties, namely, 20% or more of an interest group signifying that auditors perform the duty 'poorly'. This is explained further in chapter five.

In order to determine whether valid conclusions could be drawn from the survey results (which reflected the opinions of the 'samples' of respondents drawn from, and representing, the various interest groups) about the opinions of the interest groups *per se*, the results were subjected to two different statistical tests. The Wilcoxon-signed ranks test was applied to the survey groups' responses to determine whether the responses of the survey samples could be extrapolated to, and accepted as representing the opinions of, the relevant interest group as a whole. Similarly, the Mann-Witney test was applied to the survey groups' responses to establish whether differences in the opinions of the samples of interest group respondents could be accepted as reflecting differences in the opinions of the interest groups from which the samples were drawn. In each case, the test was applied to each of the three questions relating to each suggested responsibility of auditors listed in the questionnaire and a significance level of 0.05 was adopted.

Summary

In this chapter the methodology of the empirical research has been reported. More specifically, the survey groups, the survey instrument, and the coding and testing of the survey responses have been explained. The next chapters discuss the empirical findings.

Endnotes:

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1 In this report these groups are referred to as 'interest groups'.

2 Although the term 'responsibilities' more aptly encapsulates the nature of auditors' obligations than 'duties', in this paper the words are used with the same meaning. It should also be noted that the questionnaire was oriented towards auditors' responsibilities in the context of major public companies.

3 The means of the responses are shown as whole numbers (derived by multiplying the decimal mean by 100) rather than as decimals in order to enhance the readability of the tabulated survey results.

Chapter Four

Survey Findings: Auditors' Existing Responsibilities

The focus of this chapter is the knowledge (or, more pertinently, the lack of knowledge) of the interest groups about auditors' existing responsibilities. As will be discussed later in this report, society's lack of knowledge about auditors' responsibilities is thought to be a significant contributory factor to the 'reasonableness' component of the audit expectation-performance gap. First, the basis for identifying auditors' existing responsibilities is explained, and then the interest groups' responses to the question: 'Is the suggested responsibility [listed in the questionnaire] an existing responsibility of auditors?' are reported and discussed.

Identifying auditors' existing responsibilities

Based on a review of statute law, case law, *quasi*-government regulations (such as those of the Stock Exchange)[1] and professional promulgations, complemented by discussions with senior audit partners in some of the 'Big 5' international firms of accountants, 13 of the suggested responsibilities listed in the questionnaire were identified by the researchers as existing responsibilities of auditors. These responsibilities are presented in Appendix B together with the source of their authority.

When designing the survey instrument, care was taken to word the suggested responsibilities of auditors clearly and succinctly but in a neutral manner; that is, so as to convey the essence of the responsibility but without the exactitude that might encourage respondents to adopt an approach of 'spotting the right and wrong answers' rather than expressing their unbiased opinion. It is acknowledged that by using such wording some respondents (especially those in the auditor group who could be expected to interpret the responsibilities more precisely than members of the other groups) may have made certain assumptions which resulted in them legitimately classifying some of the responsibilities listed in Appendix B as not existing responsibilities of auditors (or, conversely, classified as existing responsibilities others not listed as such). As noted in endnote one in Appendix B, three responsibilities were particularly open to interpretation. These are the suggested responsibilities:

- to disclose the fact in the audit report, if during the audit, it is discovered that the organisation's directors or senior management have:
  - embezzled organisational assets (responsibility 2.12c);
  - committed illegal acts which directly impact the organisation's financial statements (such as bribery or political payoffs) (responsibility 2.15a);
- to examine and report (in the auditor's report) on the fairness (reliability) of information contained in the company's annual report about the directors' and senior executives remuneration policy and record (responsibility 2.17d).

However, the meaning ascribed by representatives of the survey groups to the suggested responsibilities of auditors listed in the questionnaire had been investigated very carefully during the pilot study. Additionally, the responses of a control group of six leading audit practitioners, who could be expected to be particularly knowledgeable about auditors' responsibilities under the law, auditing standards and regulations, provided guidance on the interpretation given to the suggested responsibilities by knowledge`able respondents. The interpretation accorded the suggested responsibilities of auditors listed in the questionnaire by both members of the pilot study and the control group of auditing practitioners provides support for the classification of the responsibilities as existing/not existing responsibilities of auditors adopted by the researchers. While remaining cognisant of the caveats noted above, the survey results provide a valid general indication of the knowledge of the interest groups surveyed about auditors' existing responsibilities.

Knowledge of auditors' existing responsibilities

Table 4.1 summarises the responses of the interest groups to the question: 'Is the suggested responsibility an existing responsibility of auditors?'. The 13 existing responsibilities are listed at the top of the table in descending order of agreement within the interest groups overall[2]. The 'not existing duties' follow, in ascending order of agreement. Thus, the interest groups overall were most agreed that 'to state whether or not the auditee's financial statements fairly reflect its financial affairs' (Responsibility 2.3[3]) is an existing responsibility of auditors. The mean of +91 for the interest groups overall, and that of +94 for the auditors, auditees and financial community audit beneficiaries, reflect a high level of agreement with respect to this responsibility amongst these groups. The non-financial community beneficiaries group is less agreed about the status of this responsibility but the mean of their responses of +82 still reflects a high level of agreement. At the opposite end of the spectrum, the interest groups overall, and the auditor and auditee groups in particular, are strongly agreed that 'considering and reporting (in the audit report) on the impact of the auditee on its local community' (2.24a) is not an existing responsibility of auditors.

Knowledge of interest groups overall

As may be seen from Table 4.1, the interest groups overall failed to recognise two of the auditors' existing responsibilities (the mean of responses for each of these responsibilities is negative), namely:

- for listed company auditees, to examine compliance with a specified set of the Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance (2.27bii); and
- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority [such as the police or Department of Trade and Industry (DTI)], illegal acts discovered during the audit that were committed by the auditee's directors or management (2.16).

The interest groups overall also incorrectly identified as existing responsibilities four others (the mean of responses for each of these (non)responsibilities is positive):

- to disclose in the audit report if it is discovered during the audit that the auditee's directors or senior management have embezzled auditee assets (2.12c);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a);
- to disclose in the audit report illegal acts committed by the auditee's directors or senior management which directly impact on the auditee's financial statements (such as bribery and political payoffs) that were discovered during the audit (2.15a); and
- in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority, such as the Serious Fraud Office (SFO), police or DTI, if during the audit it is discovered that information in the financial statements has been deliberately distorted (2.11d).

Nevertheless, it should be noted that for responsibilities 2.15a and 2.11d, the survey results are not statistically significant and therefore no generalised conclusions can be drawn about the opinion of the interest groups overall with respect to these duties[4]. (The same applies to four 'correctly' identified responsibilities/non responsibilities, namely, 2.17d, 2.11c, 2.8a and 2.28).

Knowledge of the auditor group

Reference to Table 4.1 reveals that the auditor group failed to recognise seven of their existing duties (2.8b, 2.14a, 2.17d, 2.11c, 2.8a, 2.27bii, and 2.16)[5].

Apart from suggested responsibilities 2.17d and 2.27bii which are discussed below, they all relate to detecting or reporting theft of auditee assets or other illegal acts. The group disagreed particularly strongly that auditors' existing responsibilities include: 'in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority (such as the SFO, police or DTI), if during the audit it is discovered that the auditee's directors or senior management have embezzled auditee assets or committed other illegal acts' (Responsibilities 2.11c and 2.16, with means of –38 and –54, respectively).

Case law and/or professional promulgations have established that auditors should plan and conduct their audits so as to have a reasonable expectation of finding any material theft of auditee assets. Where such theft has occurred, if auditors approach their audits with sufficient knowledge of their auditees' industry, business and operations, and with an appropriately sceptical attitude (as required by auditing standards), in the absence of an ingenious cover up, they should encounter suspicious circumstances if not actually uncover the theft. Once their suspicions are aroused they are required to 'probe the matter to the bottom' (per Lopes LJ, *In re Kingston Cotton Mill Co Ltd (No 2)* [1896] 2 Ch. 279). Further, if during an audit auditors discover that the auditee's directors or senior managers have embezzled auditee assets or committed other illegal acts, it seems likely that the circumstances will be such that, in compliance with auditing standards, they should report the matter to an appropriate authority in the public interest[6]. (See Appendix B.)

In addition to failing to recognise five existing responsibilities relating to theft and other illegal acts, the auditor group failed to recognise as their existing duties: 'to examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors' and senior executives' remuneration policy and record' (2.17d), and 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's governance requirements and report instances of non-compliance (2.27bii). However, in respect of responsibility 2.27bii it should be noted that the auditors were equally divided in their opinion as to whether this is, or is not, an existing responsibility (the mean of their responses is 0 – a result that is not statistically significant).

Prior to the London Stock Exchange's implementation of the Combined Code (1998), auditors were required to review and report on a number of corporate governance matters – including the auditee's directors' and senior executives' remuneration policy and packages. However, since 31 December 1998, they have been required to review their auditees' compliance with just seven of the Stock Exchange's corporate governance requirements and to report instances of non-compliance[7]. The seven requirements exclude a review of senior executives' remuneration arrangements. Instead, a separate listing rule (Rule 12.43A) requires the scope of the auditor's report on the financial statements to cover information disclosed in the company's annual report on the remuneration of each director (see Appendix B).

Table 4.1 Means of interest group responses regarding existing/non-existing responsibilities

Resp No.	Interest Group	Interest Groups Overall	Auditors	Auditees	Audit Beneficiaries: Financial Commniy	Audit Beneficiaries: Non-Fin Commnity
	No of respondents in group	*425*	*146*	*101*	*106*	*72*
	***Suggested responsibilities of auditors*[1]**	***mean*[4]**	***mean*[3]**	***mean*[3]**	***mean*[3]**	***mean*[3]**
	***Actual existing responsibilities*[2]**					
2.3	State whether auditee's financial statements fairly reflect its financial affairs	91	94	94	94	82
2.5b	Disclose in audit report doubts about the auditee's continued existence.	73	90	76	73	51
2.10	Detect deliberate distortion of auditee's financial statements	72	57	75	70	87
2.6	Ensure compliance with relevant legislation	61	76	73	36	58
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	58	57	63	49	61
2.26b	Examine & report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements	28	79	24	-1*	10
2.8b	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of auditee's assets by its directors/senior management	13	-5*	-8*	8*	55
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	11	-15	10	-1*	51
2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its directors/senior executives' remuneration policy and record	4*	-10	5*	-5*	25
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) embezzlement of the auditee's assets by its directors/senior management	4*	-38	-6*	15	45
2.8a	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by non-managerial employees	2*	-7*	-16	-10	40
2.27bii	For listed company auditees, examine compliance with a specified set of the Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-22	0*	-39	-26	-23
2.16	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts by auditee's officials	-26	-54	-38	-18	8*
	Not existing responsibilities of auditors					
2.12c	Disclose in the audit report embezzlement of the auditee's assets by its directors/senior management	15	-35	26	25	42
2.18a	Examine and report (in audit report) on the effectiveness of the auditee's internal financial controls	14	-46	38	6*	56
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on the auditee's financial statements	7*	-34	12	8*	40
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), deliberate distortion of auditee's financial statements	2*	-58	0*	16	50
2.28	Examine and report to the auditee's directors (or equivalent) on adequacy of auditee's risk management procedures	-3*	-32	9	1*	11
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	-17	-55	-21	-19	26
2.27ai	For listed company auditees, examine compliance with all of the Stock Exchange's governance requirements and report (in an auditor's report) on compliance therewith	-18	-57	-9	-25	19
2.27bi	For listed company auditees, examine compliance with a specified set of Stock Exchange's governance requirements and report (in an auditor's report) on compliance therewith	-20	-35	-32	-17	3*
2.27aii	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in an auditor's report) instances of non-compliance	-26	-39	-22	-28	-15
2.13	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) suspicions of theft or deliberate distortion of the auditee's financial statements	-34	-75	-54	-22	17

	Not existing responsibilities of auditors (continued)					
2.5a	Report to an appropriate authority (*eg* DTI or FSA) doubts about the auditee's continued existence	-37	-62	-44	-38	-4*
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in the auditee's annual report	-39	-83	-35	-50	11
2.11b	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), theft of material amount of auditee's assets by non-managerial employees	-40	-83	-57	-32	11
2.26a	Examine and report (in the audit report) on the reliability of information in the auditee's entire annual report	-40	-82	-45	-33	0*
2.7	Report breaches of tax law to the Inland Revenue	-43	-87	-60	-31	8*
2.18b	Examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls	-48	-81	-15	-66	-29
2.22a	Audit half-yearly published financial statements	-51	-83	-65	-64	10
2.15b	Disclose in the audit report illegal acts by the auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	-52	-80	-57	-48	-24
2.4	Guarantee the auditee (with a 'clean' audit report) is financially sound	-53	-91	-70	-48	-1*
2.2	Guarantee the auditee's financial statements are accurate	-55	-99	-78	-63	21
2.29	Examine and report (in the audit report) on the adequacy of the auditee's risk management procedures	-56	-92	-53	-63	-16
2.9b	Detect minor (but not petty) theft of the auditee's assets by its directors/senior management	-57	-99	-75	-55	1*
2.14b	Detect illegal acts by the auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-57	-66	-67	-56	-39
2.30	Examine and report (in an attached audit report) on reliability of the auditee's financial information on the Internet	-60	-95	-65	-71	-9*
2.1	Prepare the auditee's financial statements	-60	-97	-86	-27	-28
2.19	Examine and report (in the audit report) on auditee's IT systems	-64	-95	-56	-64	-42
2.9a	Detect minor theft of auditee's assets by non-managerial employees	-65	-100	-82	-67	-10
2.12a	Disclose in the audit report minor (but not petty) theft of the auditee's assets by non-managerial employees	-68	-99	-88	-71	-14
2.22b	Audit quarterly published financial statements	-71	-97	-80	-80	-26
2.11a	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), minor (but not petty) theft of the auditee's assets by non-managerial employees	-71	-99	-87	-67	-30
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	-72	-87	-78	-69	-53
2.17c	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its occupational health and safety policy and record	-75	-92	-81	-72	-55
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of the auditee's management and administration	-76	-100	-80	-83	-42
2.17b	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its product safety policy and record	-76	-92	-83	-74	-54

	Not existing responsibilities of auditors (continued)					
2.25	Verify every transaction of the auditee	-81	-100	-97	-86	-41
2.20	Examine and report (in the audit report) on the auditee's non-financial performance	-85	-98	-90	-80	-71
2.24b	Consider & report (in audit report) on auditee's impact on environment	-88	-100	-93	-88	-69
2.24a	Consider & report (in audit report) on auditee's impact on local community	-90	-100	-100	-92	-68

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
[2] Identified by reference to Statute law, Case law and professional promulgations.
[3] Means of responses of the relevant interest group expressed as whole numbers (*ie.* mean calculated as a decimal multiplied by 100).
[4] The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).
* Not significant at the 0.05 level (*ie.* no valid generalised conclusion can be drawn about the opinion of the interest group regarding the particular responsibility)

Knowledge of the auditees and financial community audit beneficiaries

The auditees and financial community audit beneficiaries failed to correctly identify five and six, respectively, of auditors' existing responsibilities. Three of these (responsibilities 2.8a, 2.27bii, and 2.16) were not recognised by either group; additionally, the auditee group did not correctly identify responsibilities 2.8b and 2.11c, and the financial community group, responsibilities 2.26b, 2.14a and 2.17d. (The mean of the groups' responses to each of these responsibilities is negative: see Table 4.1). However, it should be noted that for all of the responsibilities that were not recognised as such by just one of these interest groups, the survey results are not statistically significant.

The existing responsibilities of auditors which the auditees and financial community audit beneficiaries failed to recognise largely coincide with those not correctly identified by the auditor group; they relate primarily to detecting and reporting theft of auditee assets and/or other illegal acts by the auditee's senior officials. However, both groups, like the auditors, also failed to recognise as a responsibility, 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and report instances of non-compliance' (2.27bii). This was also the only existing responsibility of auditors that the non-financial community audit beneficiaries failed to identify correctly. As indicated above, this has been a responsibility of auditors in the UK since 31 December 1998. The recency of the implementation of this responsibility, 11 months before the survey, renders the survey finding understandable. However, a more unexpected result (albeit with a mean of −1, indicating that the respondents were fairly evenly divided in their opinion) was the failure of the financial community group to recognise as a duty of auditors, 'to examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements' (2.26b). Given that this group might be expected to read and rely upon the information contained in companies' annual reports, it is surprising that they are not more generally aware of auditors' responsibility in this regard[8].

In addition to failing to recognise correctly some of auditors' existing duties, both the auditees and the financial community audit beneficiaries incorrectly identified five of the suggested responsibilities listed in the questionnaire as existing responsibilities of auditors. These include 'to examine and report (in the audit report) on the effectiveness of the auditee's financial internal controls' (2.18a), and 'to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing the auditee's risk exposures' (2.28)[9]. Although auditors' involvement in reporting on the effectiveness of internal financial controls and on risk management procedures has figured prominently in corporate governance reports [for example, the Cadbury (1992), Hampel (1998), and Turnbull (1999) Reports], auditors are not (yet!) required to report on either of these matters under legal, regulatory, or professional requirements. The financial community group also incorrectly identified as an existing responsibility of auditors, 'to report privately to an appropriate authority (such as the SFO, police, or DTI) deliberate distortion of information in the auditee's financial statements discovered during the audit' (2.11d). [While the mean of this group's responses (+16) is statistically significant, the auditees were equally divided in their opinion on the status of this duty: the mean of their responses is 0.] Any deliberate distortion of the auditee's financial statements is at the heart of the auditor's remit and should be disclosed in the audit report. In the absence of any regulated industry requirement to do so, there is no additional responsibility to report such an occurrence privately to an appropriate authority.

Both the auditees and financial community audit beneficiaries also incorrectly identified as existing duties of auditors two further responsibilities, namely: 'to disclose in the audit report if it is discovered during an audit that the auditee's directors or senior management have embezzled auditee assets' (2.12c) or 'if it is discovered that they have committed other illegal acts which directly impact on the auditee's financial statements (such as bribery or political payoffs', 2.15a). As indicated in Appendix B, if auditors encounter such matters, they are required to report it in their audit report only if they disagree with the accounting treatment or with the extent, or lack, of disclosure of the matter or its consequences[10].

Knowledge of the non-financial community audit beneficiaries

As might intuitively be expected, the non-financial community group considered auditors' duties to be far more extensive than were actually required. This group incorrectly identified as existing responsibilities of auditors 15 of the suggested responsibilities listed in the questionnaire (the mean of their responses for each of these 'not existing responsibilities' is positive and in all but four cases the survey results are statistically significant: see Table 4.1). In addition, the group was equally divided in its opinion as to whether responsibility 2.26a is or is not an existing duty of auditors (the mean of the groups' responses is 0).

As may be seen from Table 4.1, these (non)responsibilities largely relate to detecting and reporting fraud and illegal acts, and to other corporate governance matters. However, among the 15 responsibilities incorrectly identified as duties of auditors, one is particularly noteworthy, namely, 'to guarantee that the auditee's financial statements are completely accurate' (2.2). This result is discussed in chapter six.

Estimate of the interest groups' 'knowledge gap'

In order to compare the four broad interest groups' relative knowledge (or, more pertinently, lack of knowledge) about auditors' existing duties, an estimate of the 'knowledge gap' of each group was calculated. For each interest group, the combined proportions of 'not sure' and incorrect responses to each of the 51 suggested duties of auditors listed in the questionnaire were totalled. This provided a measure of the group's 'total knowledge gap'. From this, the average 'knowledge gap per responsibility' was determined[11] and the relative contribution of each group to the 'knowledge gap' overall was calculated. The information is presented in Appendix C[12].

From Appendix C it may be seen that the results are as intuitively might be expected. Auditors are relatively knowledgeable about their responsibilities although some 18% are incorrect or uncertain about them[13]. The auditees and financial community audit beneficiaries, despite their dissimilar relationship with auditors, appear to have a fairly similar level of knowledge about their responsibilities – with the auditees (who are closer to auditors' work) being a little more knowledgeable than the financial community beneficiaries. (On average, auditees are 31% in error or uncertain about auditors' existing responsibilities compared with 38% of financial community audit beneficiaries). The knowledge of these groups, as might be anticipated, is less than that of auditors, but better than that of the (more remote) non-financial community group. The survey results suggest that about 52% of the latter group has very limited knowledge about auditors' responsibilities. While the apparent 'knowledge gap' of all of the interest groups should be of concern to the auditing profession, that of the 'society group' (*ie.* all non auditors) needs to be addressed with some urgency if the criticism of auditors, and the loss in confidence in their work is to be halted, if not reversed.

Summary and key issues

In this chapter, the basis for identifying 13 of the 51 suggested responsibilities of auditors listed in the survey instrument as existing responsibilities of auditors has been explained. The interest groups' responses to the question posed in relation to each suggested responsibility: 'Is the responsibility an existing responsibility of auditors?', have also been reported and discussed. Their responses provide valuable insight into the level of knowledge of the four broad interest groups about auditors' existing responsibilities – and, thus, into how well the role of auditors is understood in society in general.

The interest groups' responses indicate that each of the groups has a marked 'knowledge gap' in respect of auditors' existing responsibilities and that this gap is particularly wide amongst non-financial community audit beneficiaries. Although the knowledge gap is not a component of the audit expectation-performance gap, as will be explained in chapter six, it is considered to be a major contributor to the 'reasonableness' portion of the audit expectation-performance gap. It thus provides some insight into one possible cause of at least one component of the audit expectation-performance gap and approaches that may be adopted to tackle it.

The key issues emerging from this portion of the research include the following:

- The existing responsibilities of auditors appear to be imperfectly understood, even by auditors. The research findings suggest that measures are needed to ensure that all practising auditors (whether they be audit partners, managers or staff) are, and remain, fully informed of their responsibilities under statute and case law, *quasi*-governmental regulations and professional promulgations.
- As might be expected, auditors have a much better understanding of their existing responsibilities than do any of the other groups. Auditees and financial community audit beneficiaries (despite their contrasting relationship with the work of auditors) have a similar overall level of knowledge about auditors' existing responsibilities, but the knowledge of non-financial community audit beneficiaries seems to be very limited.
- Society's general lack of knowledge about auditors' existing responsibilities should be of concern to the auditing profession. Any profession exists in society to serve a societal need and, if a particular profession is perceived not to be serving that need, its existence is put at risk. It follows that the auditing profession is at risk if groups in society are not aware of auditors' responsibilities and, thus, are unclear as to whether or not they are serving a societal need. Further, the lack of knowledge about auditors' responsibilities is likely to mean that criticism of individual auditors, and/or of the profession as a whole, is misinformed and that the potential for informed debate about the audit function and how it might be enhanced is reduced.

Endnotes:

[1] In 2001, subsequent to the research, regulatory responsibility for companies listed on the London Stock Exchanges passed from the London Stock Exchange to the Financial Services Authority.

[2] See chapter three for an explanation of the coding of the survey responses.

[3] For ease of reference the number given to each suggested responsibility in the questionnaire is used in this report and shown in the left column of relevant tables. The questionnaire numbers are shown in sequence in Appendix A.

[4] These results are marked with an asterisk (*) in Table 4.1

[5] As indicated earlier in this chapter, the survey findings relating to the auditor group may result, at least in part, from some of this group interpreting the suggested responsibilities of auditors with greater precision than was intended by the researchers.

[6] It should be recalled from chapter three that the survey focused on the audits of major public companies.

[7] Reference to Appendix B reveals that auditors are required to report instances of non-compliance with the Combined Code only if the auditee has failed to disclose adequately its non-compliance. All of the control group of leading auditing practitioners interpreted the suggested responsibility as presented in the questionnaire as implying inadequate disclosure by the auditee.

[8] It is pertinent to note that, by its Bulletin 2001/2: *Revisions to the wording of auditors' reports on financial statements and the interim review report,* the UK's Auditing Practices Board introduced wording into the standard audit report that to some extent explains auditors' responsibility to read non-financial information contained in auditees' annual reports and to consider whether it is consistent with the audited financial statements.

[9] It should be noted that for each of these responsibilities (and also for 2.15a discussed in the following paragraph) the mean of the financial community audit beneficiaries responses is not statistically significant.

[10] All of the control group of leading auditing professionals interpreted the suggested responsibility in the questionnaire as implying a need for disagreement with the auditee's disclosure (or lack of disclosure) before reporting the matter in the audit report.

[11] Finding the average 'knowledge gap per responsibility' facilitated comparison with the results of the NZ study in 1989. In that study, the average 'knowledge gap per responsibility' of auditors, auditees, financial community, and non-financial community audit beneficiaries were 22%, 31%, 30% and 62%, respectively; the contribution to the total knowledge gap by each group was: 20% by auditors, 27% by auditees, 26% by financial community audit beneficiaries and 27% by non-financial community

[12] The information is presented as an Appendix to this report as it is supplementary to the information presented in Table 4.1. Further, while the knowledge gap of 'the society group' (that is, all non-auditors) is of relevance to the 'reasonableness' component of the audit expectation-performance gap (as discussed in Chapter 6), it is not a component of it.

[13] This result should be interpreted with caution for reasons explained in footnote 5.

Chapter Five

Survey Findings: Perceived Performance of Auditors' Responsibilities

This chapter reports the results of that part of the questionnaire which was designed to ascertain the perceived standard of performance of auditors' existing responsibilities – or, more pertinently, to identify those responsibilities that auditors are perceived to perform inadequately. As noted in chapter three, respondents were asked, in relation to each responsibility they identified as an existing responsibility of auditors, 'How well do auditors perform the responsibility?': they were provided with the options: 'Well', 'Adequately', 'Poorly', and 'Unable to judge'. As explained below, their responses to this question provide the means for ascertaining the composition of the deficient performance component of the audit expectation-performance gap.

Bases for assessing the perceived performance of auditors' existing responsibilities

As noted in chapter three, two measures were used to identify perceived sub-standard performance by auditors: the mean of interest group responses in respect of auditors' performance of each of their existing responsibilities and 20% or more of an interest group signifying that auditors perform a responsibility poorly. The mean of responses from an interest group provides a useful indicator of the group's overall assessment of auditors' performance but, for the purpose of deciding whether corrective action to remedy perceived sub-standard performance is warranted, the proportion of an interest group indicating that auditors perform a responsibility poorly affords a pertinent measure. An interest group as a whole may adjudge auditors' performance of a duty to be satisfactory but a significant proportion of the group may hold the contrary view and this may be sufficient (or the potential consequences may be sufficiently serious) to warrant remedial action being initiated by the auditing profession. While acknowledging that selection of any point measure to define 'a significant proportion' of an interest group is arbitrary, for the purposes of the research a measure of 20% was adopted. It was considered that if 20% or more of an interest group signify that auditors' performance of a duty is poor, then dissatisfaction is sufficiently widespread for the profession to examine the propriety of introducing corrective measures.

Perceived performance of auditors' existing responsibilities

Opinions of the interest groups overall

Examination of Table 5.1 reveals that the interest groups overall considered that auditors perform seven of their existing responsibilities well or satisfactorily. (For each of these responsibilities the mean of their responses is 2.0 or greater and less than 20% of respondents signified that auditors perform the responsibility poorly.) The interest groups overall rated particularly highly auditors' performance of four of their responsibilities, namely:

- to ensure the auditee's financial statements comply with relevant legislation (2.6);
- to state whether or not the auditee's financial statements fairly reflect its financial affairs (2.3);
- to examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors' and senior executives' remuneration policy and record (2.17d); and
- on information in its annual report that is inconsistent with its financial statements (2.26b).

However, the interest groups overall adjudged six of auditors' responsibilities to be performed inadequately. For five of these, the mean of the interest groups' responses overall was 1.9 or less (see Table 5.1). These were the responsibilities:

- to detect the theft of a material amount of the auditee's assets by its directors or senior management, or by non-managerial employees (2.8b, 2.8a);
- to detect illegal acts committed by the auditee's directors or management which directly impact on the financial statements (such as bribery or political payoffs) (2.14a);
- in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority [such as the Serious Fraud Office (SFO), police, or Department of Trade and Industry (DTI)] if during the audit it is discovered that the auditee's directors or senior management have embezzled auditee assets or committed other illegal acts (2.11c and 2.16).

Table 5.1 Assessment of auditors' performance based on the means of interest group responses and proportion of the interest groups signifying the responsibilities are poorly performed

Resp No.	Interest Group	Interest Groups Overall		Auditors		Auditees		Audit Beneficiaries: Financial Community		Audit Beneficiaries: Non-Fin Community	
	No of respondents in group	*425*		*146*		*101*		*106*		*72*	
	Suggested responsibilities of auditors[1] ***Performance – Good or Satisfactory[2]***	*mean[4]*	*Poor Perf. Av.%[5]*	*mean[4]*	*Poor Perf. %[3]*	*mean*	*Poor Perf.%[3]*	*mean*	*Poor Perf. %[3]*	*mean*	*Poor Perf. %[3]*
2.6	Ensure compliance with relevant legislation	2.4	2	2.6	1	2.5	1	2.4	3	2.2	10
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	2.3	5	2.6	1	2.3	2	2.2	9	2.2	7
2.17d	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors/ senior executives' remuneration policy and record*	2.3	7	2.5	3	2.3	7	2.1	9	2.1	7
2.26b	Examine and report (in the audit report) on information in the annual report which is inconsistent with its financial statements	2.2	4	2.4	3	2.2	0	2.1	7	2.1	9
2.27bii	For listed company auditees, examine compliance with a specified set of the Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance*	2.1	10	2.4	2	***1.9***	***24***	***1.9***	7	2.0	7
2.10	Detect deliberate distortion of the auditee's financial statements	2.0	14	2.2	10	2.1	16	***1.8***	***20***	2.0	11
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	2.0	15	2.2	10	2.0	18	***1.7***	***20***	***1.9***	12
	Performance – Unsatisfactory[2]										
2.11c	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of the auditee's assets by its directors/senior management*	**1.9**	12	2.1	8	***1.9***	13	***1.7***	***20***	2.0	5
2.14a	Detect illegal acts by auditee officials which directly impact on the auditee's financial statements (*eg* political payoffs)*	**1.9**	19	***1.9***	***22***	***1.9***	***22***	***1.7***	19	2.0	13
2.5b	Disclose in the audit report doubts about the auditee's continued existence	2.0	***21***	2.1	14	2.0	***22***	***1.9***	***28***	***1.8***	***20***
2.8b	Detect theft of a material amount (*eg* >5% of turnover or total assets) of the auditee's assets by directors/senior management*	**1.9**	***20***	2.0	14	***1.9***	***26***	***1.9***	17	***1.7***	***22***
2.16	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts by auditee officials*	***1.8***	16	***1.9***	14	***1.6***	***25***	***1.6***	15	2.0	10
2.8a	Detect theft of a material amount (*eg* >5% of turnover or total assets) of the auditee's assets by non-managerial employees*	***1.8***	19	2.0	14	***1.9***	23	***1.6***	16	***1.6***	24

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
[2] An average mean of 1.9 (calculated from responses to options other than 'unable to judge') and an average of 20% of the interest groups signifying that auditors perform the responsibility poorly have been adopted as points of differentiation between satisfactory and unsatisfactory performance by auditors. (Use of the average of the interest groups' responses eliminates the effect of difference sample sizes).
[3] Proportion of the interest group signifying that auditors perform the responsibility poorly.
[4] The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).
[5] Average of the proportions of the four identified interest groups signifying that auditors perform the responsibility poorly.
* Not recognised by auditors as an existing responsibility (See Figure 4.1).

Auditors' inadequate performance of their duty 'to detect the theft of a material amount of the auditee's assets by its directors or senior management' (2.8b) was also signalled by 20% of the respondents signifying that the duty is performed poorly. The perceived inadequate performance of the remaining 'unsatisfactory' responsibility – 'to disclose doubts in the audit report about the auditee's continued existence' (2.5b) – was similarly identified by more than 20% of the interest groups overall signifying that auditors' perform the duty poorly.

In respect of the six responsibilities adjudged by the interest groups overall to be performed to a less than satisfactory standard by auditors, it is pertinent to note that five (2.8a, 2.8b, 2.11c, 2.14a, and 2.16) were not recognised as existing responsibilities by the auditor group (see Table 5.1).

Opinions of the auditor group

Reviewing the assessment of auditors' performance by the individual interest groups presented in Table 5.1, it is not surprising to find that auditors rate their performance more highly than do the other groups. For only two responsibilities is the mean of their responses less than 2.0, namely, in respect of the responsibilities 'to detect illegal acts committed by the auditee's directors or senior management which directly impact on the financial statements (such as bribery and political payoffs) (2.14a) and 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority illegal acts discovered during the audit that have been committed by the auditee's directors or senior management' (2.16). Further, in only one case – in relation to responsibility 2.14a (see above) – did more than 20% of the auditor group adjudge auditors' performance to be poor. (Interestingly, the auditor group did not recognise this as one of their existing duties: see Table 4.1.)

Opinions of the auditees

The auditees rated auditors' performance of their responsibilities less highly than the auditors themselves. For five responsibilities, perceived deficient performance by auditors is reflected in both the means of the auditees' responses and by 20% or more of the group signifying that auditors perform the responsibility in question poorly. These responsibilities include four of the six responsibilities considered by the interest groups overall to be performed inadequately (*ie.* 2.8a, 2.8b, 2.14a and 2.16) and also the responsibility 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance' (2.27bii).

Additionally, the auditee group signalled perceived inadequate performance by auditors in respect of their responsibilities 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the SFO, police or DTI) embezzlement of auditee assets by the directors or senior management discovered during the audit' (2.11c; with a mean of 1.9) and 'to disclose in the audit report doubts about the auditee's continued existence (2.5b; with 22% of the auditee group signifying poor performance of this responsibility by auditors).

Opinions of audit beneficiaries

As might perhaps be expected, given their potential reliance on the outcome of auditors' work, the financial community audit beneficiaries were the least satisfied of the interest groups with auditors' performance. Of the 13 existing duties of auditors included in the questionnaire, the financial community group signalled that auditors perform nine to an unsatisfactory standard (responsibilities 2.5b, 2.8a, 2.8b, 2.10, 2.11c, 2.12d, 2.14a, 2.16, and 2.27bii: see Table 5.1). For each of these responsibilities, the mean of the group's responses is 1.9 or less. In addition, for four of these responsibilities (2.5b, 2.10, 2.11c and 2.12d) 20% or more of the group indicated that auditors perform the duty poorly. The extent of the financial community group's dissatisfaction with auditors' performance is reflected in the fact that the mean of their responses in respect of auditors' responsibilities 'to detect theft of a material amount of the auditee's assets by non-managerial employees' (2.8a) and 'to report privately to an appropriate authority (such as the police or DTI) illegal acts committed by the auditee's directors or senior management discovered during the audit' (2.16) equals the survey minimum of 1.6. (The mean of auditees' responses to responsibility 2.16, and that of the non-financial community audit beneficiaries in relation to responsibility 2.8a, was also 1.6). Additionally, in respect of auditors' duty 'to disclose doubts in the audit report about the auditee's continued existence' (2.5b), 28% of the financial community group adjudged auditors' performance to be poor – the highest level of dissatisfaction indicated by any group about the performance of auditors' duties).

Unlike their financial community counterparts, the non-financial community audit beneficiaries considered that auditors perform just four of their duties inadequately (*ie*. responsibilities 2.5b, 2.8a, 2.8b and 2.12d). For each of these duties, the mean of the group's responses is 1.9 or less and in three cases (for all but responsibility 2.12d), 20% or more of the group indicated that auditors perform the duty poorly.

Deficient performance component of the audit expectation-performance gap

As noted in chapter two (and depicted in Figure 2.1), the audit expectation-performance gap comprises two components: the 'reasonableness gap' and the 'performance gap', with the latter being sub-divided into the 'deficient standards' and 'deficient performance' gaps. The deficient performance gap, which is of relevance to this chapter, is defined as the gap between the expected and perceived performance of auditors' responsibilities, as expected and perceived by society[1]. In accordance with this definition, the duties contributing to the deficient performance gap may be identified from the responses of all 'non-auditor' respondents (designated 'the society group')[2]. This group's assessment of auditors' performance of their duties is presented in Table 5.2.

From an analysis of Table 5.2, it may be seen that the society group adjudged auditors' performance of seven of their responsibilities to be sub-standard (Responsibilities 2.5b, 2.8a, 2.8b, 2.11c, 2.12d, 2.14a and 2.16). For each of these responsibilities the mean of the society group's responses is 1.9 or less. Additionally, for three of these responsibilities (*ie*. 2.5b, 2.8a, and 2,8b), more than 20% of the society group signified that auditors perform the responsibility poorly.

Each of the seven responsibilities which auditors are perceived to perform unsatisfactorily is likely to generate dissatisfaction with, and criticism of, auditors. Thus, these responsibilities are conceived to be elements of the deficient performance component of the audit expectation-performance gap. Further, the relative contribution of each of these responsibilities to the deficient performance gap may be determined by reference to the extent of unfulfilled expectations attaching to the responsibility. This is reflected in the proportion of the society group who signified that auditors perform the duty poorly and whose expectations with respect to the duty are, therefore, not being fulfilled. The relative contribution of each duty to the gap is shown in Table 5.2.

From Table 5.2 it may be seen that auditors' poor performance (as perceived by the society group) of their responsibility 'to disclose doubts in the audit report about the auditee's continued existence' (2.5b) accounts for 17% of the deficient performance gap. (The mean of auditors' responses regarding their performance of this duty was 2.1 and only 14% of the group adjudged their performance to be poor: see Table 5.1). In November 1994, the UK's Auditing Practices Board (APB) published a new standard relating to this issue (SAS 130: *The Going Concern Basis in Financial Statements*). Notwithstanding its publication some years before the survey, assuming that auditors are complying with the standard, the society group may, in the not too distant future, recognise an improvement in auditors' performance in this regard[3].

Table 5.2 Society group's[1] assessment of auditors' performance of their existing responsibilities

Resp No.	Suggested responsibilities of auditors[2]	Means of responses	Poorly	OK[4]	Well	Unable to judge	Contrib. to deficient perform. gap[5]
	Deficient performance gap responsibilities[3]	*mean*	%	%	%	%	%
2.5b	Disclose in the audit report doubts about the auditee's continued existence	***1.9***	***23***	33	18	26	17
2.8b	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by its directors/senior management*	***1.8***	***22***	34	11	33	17
2.8a	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by non-managerial employees*	***1.7***	***21***	35	10	34	16
2.16	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts by auditee officials*	***1.7***	17	27	4	52	13
2.14a	Detect illegal acts by auditee officials which directly impact on the auditee's financial statements (*eg* political payoffs)*	***1.9***	18	37	9	36	14
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	***1.9***	17	40	9	34	13
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of auditee's assets by directors/senior management*	***1.9***	13	38	6	43	10
	Non-deficient performance gap responsibilities						100
2.27bii	For listed company auditees, examine compliance with a specified set of the Stock Exchange's governance requirements and report (in an auditor's report) instances of non-compliance	2.0	13	36	9	42	-
2.10	Detect deliberate distortion of the auditee's financial statements	2.0	16	42	15	27	-
2.26b	Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements	2.1	5	44	15	36	-
2.17d	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors/senior executives' remuneration policy and record*	2.2	8	41	23	28	
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	2.2	6	50	27	17	-
2.6	Ensure compliance with relevant legislation	2.4	5	40	33	22	-

1. All non-auditor interest groups (auditees, financial community and non-financial community audit beneficiaries)
2. The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire
3. An average mean of 1.9 (calculated from responses to options other than 'unable to judge') and an average of 20% of the 'society' interest groups signifying that auditors perform the responsibility poorly have been adopted as points of differentiation between satisfactory and unsatisfactory performance by auditors. (Using the average of the 'society' interest groups' responses eliminates the effect of difference sample sizes).
4. Represents the response option 'adequately'.
5. Based on the average proportion of the society interest groups group who signified that auditors perform the responsibility poorly.

* Not recognised by auditors as an existing responsibility (see Table 4.1).

When reviewing the responsibilities comprising the deficient performance gap, it is pertinent to note that, apart from their responsibilities 'to disclose in the audit report doubts about the auditee's continued existence' and 'deliberate distortion of information in the auditee's financial statements discovered during the audit (2.5b and 2.12d), auditors failed to recognise as existing responsibilities those responsibilities constituting the deficient performance component of the audit expectation-performance gap. This may account, at least in part, for their deficient performance of these duties, as perceived by society. It also suggests that improved education is required for auditors to ensure they are, and remain, fully aware of their responsibilities under statue and case law, *quasi*-governmental regulations, and professional promulgations.

The five responsibilities not recognised as such by auditors all relate to detecting or reporting theft of the auditee's assets by its directors, senior management or non-managerial employees, or to other illegal acts committed by the auditee's directors or management. Auditors' responsibilities in these regards have been the subject of extensive controversy and debate during the past 80 or so years – with auditors tending to downplay their responsibilities, and the courts, politicians and society in general continuing to make clear that they expect auditors to play an active role in these areas. In recent years, new auditing standards issued in the UK, US and by the International Auditing Practices Committee have provided more specific (and more rigorous) guidance for auditors in the performance of their responsibilities in respect of detecting and reporting corporate fraud and other illegal acts discovered during their audits[4]. It might reasonably be envisaged that, as auditors become more familiar with the new standards, and apply their provisions in the manner intended, society will perceive improved performance.

Summary and key issues

This chapter has focused on the standard of performance of auditors' responsibilities, as perceived by auditors' interest groups. It has been noted that two measures were adopted to identify perceived sub-standard performance – the mean of interest group responses of 1.9 or less and 20% or more of an interest group signifying that auditors perform a particular responsibility poorly.

Key findings of this portion of the research include the following:

- While auditors are the least critical of the standard of performance of their duties, the financial community audit beneficiaries are the most critical.
- Based on the responses of the society group (that is, all non auditors) seven responsibilities have been identified as constituting the deficient performance component of the audit expectation-performance gap.
- Auditors do not recognise as existing responsibilities five of the seven responsibilities comprising the deficient performance gap and this may explain, at least in part, the perceived deficient performance of these duties.
- The majority of the deficient performance gap duties relate to auditors' responsibilities in respect of detecting and reporting corporate fraud and other illegal acts discovered during their audits. These responsibilities have been the subject of considerable controversy and debate for the past 80 or so years but more specific and more rigorous guidance for auditors provided in new auditing standards may result in improved performance in these regards or, more pertinently in the context of this research, in society's perception of improved performance by auditors.

Endnotes:

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[1] See chapter one, endnote one.

[2] In order to eliminate the effect of differing sample sizes, the average of the responses of the three non-auditor interest groups (*ie*. auditees, financial and non-financial, community audit beneficiaries) has been adopted to represent the opinions of 'the society group'.

[3] In 1989, this duty contributed 37% of the deficient performance gap in NZ. To the extent that comparisons of auditors' performance in the UK and NZ are valid, the finding that this duty contributed 17% of the deficient performance gap in the UK in 1999 indicates that auditors' performance of this duty has improved significantly between 1989 and 1999. This may well, at least in part, be due to the adoption of the new Going Concern auditing standard. (A similar standard was issued in both the UK and NZ at approximately the same time).

[4] For a discussion of the development of auditors' responsibilities for detecting and reporting corporate fraud, see Porter (1997).

Chapter Six

Survey Findings: Responsibilities Auditors Should Perform and Those Reasonably Expected of Auditors

This chapter reports the results of that part of the questionnaire which addressed the question 'What responsibilities *should* auditors perform'? As will be explained below, the interest groups' responses to this question provided the basis for determining two key boundaries of the audit expectation-performance gap – the responsibilities society expects auditors to perform and the responsibilities it is reasonable to expect of auditors. Once these boundaries were determined, the composition of the 'reasonableness' and 'deficient standards' portions of the expectation-performance gap could be established. However, before examining these latter aspects of the research, the survey findings pertaining to the responsibilities the interest groups signified that auditors should perform are reported.

Ascertaining the responsibilities auditors should perform

As noted in chapter three, for each suggested responsibility of auditors listed in the questionnaire, respondents were asked to indicate, by selecting from the options 'yes', 'no' and 'not sure', whether the responsibility should or should not be performed by auditors. Table 6.1 shows first, in *des*cending order of agreement, the responsibilities the respondents as a whole considered auditors *should* perform; then, in *as*cending order of agreement, the responsibilities they indicated auditors *should not* perform. Additionally, the mean of responses of each of the four broad interest groups are presented, as is the proportion of each interest group, and of the society group (*ie*. all non-auditors)[1], who signified that auditors should perform the responsibility in question (*ie*. they selected the option 'yes').

Opinions of the interest groups overall

As Table 6.1 shows, the interest groups overall signified that 23 of the 51 responsibilities listed in the questionnaire should be performed by auditors (the means of their responses to these responsibilities are positive; for 17 responsibilities the mean of their responses is +20 or more, signalling a relatively high level of agreement regarding auditors' performance of these responsibilities). As might be expected, virtually all of auditors' existing responsibilities are among those the interest groups overall considered auditors should perform; the only omission is auditors' duty 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and to report (in the audit report) instances of non-compliance' (2.27bii). However, in place of 2.27bii, the interest groups overall signified that auditors should be required 'to examine listed company auditees' compliance with all (or a specified set) of the Stock Exchange's corporate governance requirements and to report whether or not they have complied with those requirements' (2.27ai and 2.27bi, respectively). In other words, the respondents indicated that auditors should be required to report on auditees' compliance with the Stock Exchange's corporate governance requirements – rather than merely instances of non-compliance.

In addition to auditors' existing responsibilities, the 17 responsibilities most strongly endorsed by the respondents as responsibilities auditors should perform include the following non-existing responsibilities:

- to disclose the fact in the audit report if during an audit it is discovered that the directors or senior management have embezzled auditee assets or committed other illegal acts which directly impact on the financial statements (such as bribery or political payoffs) (2.12c and 2.15a);

- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a);
- to examine and report (privately to the auditee's directors) on the adequacy of procedures for identifying and managing the auditee's risk exposures (2.28);
- in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority [such as the Serious Fraud Office (SFO), police or the Department of Trade and Industry (DTI)], if during the audit it is discovered that information in the auditee's financial statements has been deliberately distorted (2.11d).

Table 6.1 Responsibilities the interest groups consider auditors should perform

Resp No.	Interest Group	Interest Groups Overall	Auditors		Auditees		Audit Beneficiaries: Financial Community		Audit Beneficiaries: Non-Fin Community		Society Group[6]
	No of respondents in group	*425*	*146*		*101*		*106*		*72*		*279*
	Suggested responsibilities of auditors[1]	*mean[3]*	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*%[5]*
	Responsibilities auditors should perform[2]										
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	91	94	97	92	96	94	96	82	88	93
2.5b	Disclose in the audit report doubts about the auditee's continued existence.	84	87	93	88	90	89	92	70	74	85
2.10	Detect deliberate distortion of auditee's financial statements	83	61	80	82	89	91	95	97	97	94
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	78	69	84	77	88	85	91	81	87	87
2.6	Ensure compliance with relevant legislation	70	74	86	77	84	56	75	71	81	80
2.12c	Disclose in the audit report embezzlement of the auditee's assets by its directors/senior management	56	13	55	64	80	73	84	73	82	82
2.15a	Disclose in the audit report illegal acts by auditee officials which directly impact on the auditee's financial statements	50	7*	48	53	76	66	81	75	79	79
2.11c	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of the auditee's assets by its directors/senior management	50	16	56	38	67	67	81	80	86	78
2.18a	Examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls	49	2*	51	59	79	66	80	68	79	79
2.26b	Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements	49	87	94	35	63	46	69	29	53	62
2.14a	Detect illegal acts by auditee officials which directly impact on the auditee's financial statements (*eg* political payoffs)	44	-2*	47	39	67	56	75	84	87	76
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	44	8*	53	27	62	63	78	79	82	74
2.28	Examine and report to the auditee's directors (or equivalent) on the adequacy of auditee's risk management procedures	41	13	54	54	72	53	74	44	58	68
2.11d	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), deliberate distortion of the auditee's financial statements	38	-17	41	29	62	62	79	79	85	75
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	30	7*	53	8*	51	46	70	60	73	65

2.16	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts committed by auditee officials	27	-6*	44	12	54	49	69	52	65	63
2.17d	Examine and report (in the audit report) on reliability of information in auditee's annual report about directors/senior executives' remuneration policy & record	20	-7*	46	27	60	18	57	40	63	60
2.13	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) suspicions of theft or deliberate distortion of auditee's financial statements	19	-35	29	-17	35	55	71	71	79	62
2.12b	Disclose in the audit report theft of a material amount of the auditee's assets by non-managerial employees	18	-30	34	6*	50	41	67	55	74	64
2.27ai	For listed company auditees, examine compliance with all of the Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	10	-27	36	14	50	11	50	43	52	51
2.5a	Report to an appropriate authority (*eg* DTI or FSA) doubts about the auditee's continued existence.	8*	-32	33	-12	37	31	60	46	61	53
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in the auditee's annual report	3*	-45	27	12	50	16	54	29	54	53
2.27bi	For listed company auditees, examine compliance with a specified set of Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	3*	-8*	45	-8*	36	15	51	13	31	N/A[7]
	Responsibilities auditors should not perform[2]										
2.27aii	For listed company auditees, examine compliance with all of the Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-2*	-4*	46	-9*	38	10*	52	-3*	26	39
2.30	Examine and report (in attached audit report) on reliability of the auditee's financial information on the Internet	-2*	-42	26	0*	42	1*	41	32	47	43
2.22a	Audit half-yearly published financial statements	-3*	-19	39	-28	31	-4*	45	41	61	46
2.11b	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), theft of material amount of auditee assets by non-managerial employees	-4*	-66	16	-24	32	37	64	39	63	53
2.27bii	For listed company auditees, examine compliance with a specified set of Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-4*	10*	53	-12	37	0*	44	-12	18	33
2.26a	Examine and report (in the audit report) on the reliability of information in the auditee's entire annual report	-7*	-50	23	-6*	43	0*	49	30	55	49
2.7	Report breaches of tax law to the Inland Revenue	-8*	-66	15	-40	24	26	55	49	66	48
2.29	Examine and report (in the audit report) on the adequacy of the auditee's risk management procedures	-11	-67	15	-12	40	4*	46	32	48	45
2.18b	Examine and report (in audit report) on the effectiveness of auditee's internal non-financial controls	-20	-55	21	21	59	-30	31	-14	32	41
2.4	Guarantee that the auditee (with 'clean' audit report) is financially sound	-22	-84	8	-38	27	-8*	43	43	65	45

2.15b	Disclose in the audit report illegal acts by auditee officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	-24	-56	19	-21	34	-25	31	5*	42	36
2.14b	Detect illegal acts by auditee officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-29	-60	18	-38	24	-24	31	5*	44	33
2.19	Examine & report (in audit report) on auditee's IT systems	-32	-77	10	-9*	41	-25	32	-17	30	34
2.9b	Detect minor (but not petty) theft of the auditee's assets by its directors/senior management	-38	-94	3	-63	15	-23	29	30	57	34
2.2	Guarantee the auditee's financial statements are accurate	-41	-99	1	-77	10	-30	33	44	67	37
2.22b	Audit quarterly published financial statements	-47	-70	14	-57	15	-58	19	-2*	36	23
2.21	Examine & report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	-50	-89	4	-50	18	-47	21	-15	36	25
2.11a	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), minor (but not petty) theft of the auditee's assets by non-managerial employees	-53	-97	1	-71	10	-37	26	-5*	40	25
2.9a	Detect minor (but not petty) theft of the auditee's assets by non-managerial employees	-54	-99	0	-71	12	-39	21	-5*	38	27
2.17c	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its occupational health and safety policy and record	-55	-80	9	-49	20	-63	16	-29	27	21
2.17b	Examine & report (in audit report) on reliability of information in the auditee's annual report about its product safety policy and record	-56	-79	9	-48	20	-66	15	-30	27	21
2.17a	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its equal employment opportunities policy and record	-58	-81	9	-53	18	-64	16	-32	25	20
2.1	Prepare the auditee's financial statements	-58	-96	2	-87	6	-17	41	-31	30	26
2.12a	Disclose in the audit report minor (but not petty) theft of the auditee's assets by non-managerial employees	-59	-98	1	-81	7	-63	13	8*	48	23
2.20	Examine and report (in the audit report) on the auditee's non-financial performance	-64	-88	4	-56	18	-59	15	-52	16	16
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	-68	-87	6	-65	13	-76	8	-45	19	13
2.24a	Consider and report (in audit report) on the impact of the auditee on its local community	-73	-92	3	-69	10	-86	3	-46	19	11
2.25	Verify every transaction of the auditee	-79	-100	0	-93	2	-84	7	-37	22	10

1 The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
2 Responsibilities identified as those auditors should/should not perform based on the means of interest groups' responses.
3 The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).
4 Means of responses of the relevant interest group expressed as whole numbers (ie. mean calculated as a decimal multiplied by 100).
5 Proportion of interest group signifying that auditors should perform the responsibility.
6 Average of the proportion of non-auditor interest groups signifying auditors should perform the responsibility. (Averaging eliminates different sample sizes.)
7 2.27bi subsumed by 2.27ai as explained in text.
* Not significant at 0.05 level (*ie*. no valid generalised conclusion can be drawn about the opinion of the interest group regarding the responsibility).

It is pertinent to recall that the interest groups overall identified four of these five 'non-existing responsibilities' (namely, 2.12c, 2.15a, 2.18a and 2.11d) as existing duties of auditors and that the mean of their responses for responsibility 2.28 was –2 (a result that, as for duties 2.15a and 2.11d, is not statistically significant: see Table 4.1).

Opinions of the four broad interest groups

Examining the means of responses of the individual interest groups, the survey results are as intuitively might be expected. The auditors identified the smallest number of responsibilities as those they should perform, the auditees identified the next smallest number and the audit beneficiaries (more specifically, the non-financial community group) the greatest number. Similarly, in general, the auditees and, more particularly the audit beneficiaries (especially the non-financial community group), displayed greater agreement than did the auditors about the responsibilities auditors should perform (the positive means of the former groups' responses for responsibilities they signified auditors should perform are generally higher than those of the auditor group: see Table 6.1).

Opinions of the auditor group

The auditors indicated that they should be required to perform 14 of the 51 suggested responsibilities listed in the questionnaire (their responses to these duties are positive: see Table 6.1). These include 13 of the 17 responsibilities most strongly supported by the interest groups overall as responsibilities auditors should perform, but exclude (from the 17) three of their existing duties, namely: 'to detect and, in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority such as the police or DTI, illegal acts committed by the auditee's directors or senior management' (2.14a and 2.16), and 'to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its directors' and senior executives' remuneration policy and record (2.17d). However, it should be noted that in each of these three cases the survey results are not statistically significant. The fourth of the 'top 17' responsibilities recognised by the interest groups overall as responsibilities auditors should perform, but not so identified by the auditor group, is that of: 'in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority (such as the SFO, police or DTI) if during an audit it is discovered that information in the auditee's financial statements has been deliberately distorted' (2.11d). As noted in chapter five, such distortion should be reported in the audit report (which is on the public record) so there should be no need also to report it privately to an appropriate authority.

Unlike the interest groups overall, the auditors recognised as a responsibility they should perform their existing responsibility: 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and to report instances of non-compliance' (2.27bii). As mentioned above, the interest groups overall considered that auditors should be required to perform the more demanding responsibility of reporting on listed company auditees' compliance with the Stock Exchange's corporate governance requirements, rather than merely reporting instances of non-compliance.

Opinions of the auditees

The auditees signified that auditors should perform all of the responsibilities identified by the auditors as responsibilities they should perform (with the exception of responsibility 2.27bii) and also a further eight responsibilities (namely, 2.14a, 2.11d, 2.16, 2.17d, 2.12b, 2.27ai, 2.23 and 2.18b) – a total of 21 of the 51 suggested responsibilities listed in the questionnaire. Additionally, they were equally divided as to whether or not it should be auditors' responsibility 'to examine and report (in an attached auditor's report) on the reliability of financial information provided by the auditee on the internet' (2.30).

The additional duties the auditees (as compared with the auditors) considered that auditors should perform seem to reflect a desire by them for externally provided assurance on matters that might affect the confidence of stakeholders in their (that is, the auditee's) management. More specifically they seem to seek assurance about:

- the absence (or, if discovered, the reporting) of illegal acts committed by the auditee's directors or senior management (responsibilities 2.14a and 2.16), deliberate distortion of information presented in the financial statements (2.11d), and the theft of a material amount of the auditee's assets by non-managerial employees (2.12b);
- the reliability of information disclosed the auditee's annual report about its directors' and senior executives' remuneration policy and record (2.17d), its compliance with all of the Stock Exchange's corporate governance requirements (2.27ai), and the effectiveness of its internal non-financial (as well as financial) controls (2.18a and 2.18b);
- the reasonableness of financial forecasts included in its annual report (2.23).

Opinions of financial community audit beneficiaries

As indicated above, the financial community audit beneficiaries signified that auditors should perform significantly more responsibilities than those identified by the auditors and auditees. They considered that auditors should perform 28 of the 51 suggested responsibilities listed in the questionnaire; these include the 21 responsibilities identified by the auditees as responsibilities auditors should perform other than: 'to examine and report (in the audit report) on the effectives of the auditee's internal non-financial controls (2.18b). They also signalled that auditors should perform another eight responsibilities (namely, responsibilities 2.13, 2.5a, 2.27bi, 2.27aii, 2.30, 2.11b, 2.7, and 2.29), and they were equally divided as to whether or not auditors should be required: 'to examine and report (in the audit report) on the reliability of information in the auditee's entire annual report' (2.26a) and 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and to report instances of non-compliance' (2.27bii). As noted above, responsibility 2.27bi (which was recognised by the financial community group as a responsibility auditors should perform) is more demanding than, and subsumes, 2.27bii.

The additional responsibilities the financial community group considered auditors should perform seem to focus principally on securing increased assurance regarding corporate governance matters. More specifically about:

- listed company auditees' compliance with the Stock Exchange's corporate governance requirements (2.27bi and 2.27aii);
- reporting (privately to an appropriate authority such as the SFO, police or DTI) if during an audit it is discovered that theft of a material amount of auditee assets has been committed by non-managerial employees (2.11b), or if suspicious circumstances are encountered suggesting that theft or deliberate distortion of financial information may have occurred (2.13);
- assessment and reporting (in the audit report) of the adequacy of the auditee's procedures for identifying and managing its risk exposures (2.29).

They also seem to seek increased assurance regarding:

- auditors reporting (privately to an appropriate authority such as the DTI or Financial Services Authority) doubts they have about the ability of an auditee to continue as a going concern (2.5a);
- the reliability of financial information provided by the auditee on the internet (2.30); and
- auditors reporting to the Inland Revenue breaches of tax laws discovered during an audit (2.7). This responsibility is discussed in a subsequent section below.

Opinions of non-financial community audit beneficiaries

The non-financial community audit beneficiaries considered that auditors should perform a wide range of responsibilities. These include 27 of the 28 responsibilities identified by the financial community group as responsibilities auditors should perform – the exception being responsibility 2.27aii, but it should be noted that the survey result in this instance is not statistically significant. The non-financial community group signified that auditors should also perform the following eight responsibilities:

- to audit half-yearly published financial statements (2.22a);
- to examine and report (in the audit report) on the reliability of information contained in the auditee's entire annual report (2.26a);
- to guarantee that audited financial statements are completely accurate and that an auditee whose financial statements have an unqualified audit report is financially sound (2.2 and 2.4);
- to detect and, if discovered, to report in the audit report, illegal acts committed by the auditee's directors or senior management that only indirectly impact on the financial statements (such as breaches of occupational safety and environmental laws and regulations) (2.14b and 2.15b);
- to detect minor (other than petty) theft of auditee assets by the auditee's directors or senior management (2.9b);
- to report (in the audit report) if during an audit it is discovered that minor (other than petty) theft has been committed by non-managerial employees (2.12a).

Thus the non-financial community group signified that auditors should perform 35 of the 51 suggested responsibilities of auditors included in the questionnaire. Two of these responsibilities are particularly noteworthy, namely: 'to guarantee that audited financial statements are completely accurate' (2.2) and 'to guarantee that an auditee whose financial statements have an unqualified audit report is financially sound' (2.4). It is suggested that identifying these responsibilities as elements of what should be expected of auditors may reflect this interest group's lack of knowledge of the audit process. (These responsibilities are discussed below.)

It is interesting to note that, notwithstanding the wide range of duties the non-financial community group identified as duties auditors should perform, the mean of their responses to responsibility 2.27bii (like that of the auditees) was –12, compared with means of 0 and +10 for the financial community group and auditors, respectively. However, rather than supporting auditors being required 'to examine listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and to report (in the audit report) instances of non-compliance' (2.27bii), they were significantly agreed that auditors should be required 'to examine listed company auditees' compliance with all of the Stock Exchange's corporate governance requirements and to report (in the audit report) whether or not they have complied with those requirements (2.27ai). The mean of their responses for this responsibility is +43, compared with +11, +14, and –27 for the financial community group, auditees and auditors, respectively. This result, together with the other responsibilities the non-financial community group signalled auditors should perform, suggests that these audit beneficiaries believe that auditors should play a significantly broader role in monitoring auditees' activities than do the other interest groups. This may reflect this group's more distant and indirect relationship with auditors, and their greater 'knowledge gap' in respect of the audit function, or it may signal a genuine desire by this group for the external audit function to be extended to fulfil a perceived societal need.

Perhaps somewhat surprisingly, given the public's apparent growing support for social responsibility reporting by companies and the wide range of responsibilities the non-financial community group indicated auditors should perform, this group (like the other interest groups) did not signify that auditors should perform duties relating to corporate social responsibility issues (for example, responsibilities 2.17a, 2.17b, 2.17c, 2.24a, and 2.24b: see Table 6.1). Similarly surprisingly, given the current high level of interest in the issues, the non-financial community group did not identify as responsibilities auditors should perform: 'to examine and report (in the audit report) on the auditee's computer systems, and on the effectiveness of its internal non-financial controls'

(2.19 and 2.18b, respectively). However, like their financial community counterparts, they did signal that auditors should be required: 'to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet' (2.30).

Identifying responsibilities reasonably expected of auditors

As may be discerned from the definition of the expectation-performance gap provided in chapter two and the depiction of the gap in Figure 2.1, identifying the responsibilities reasonably expected of auditors is of critical importance for differentiating between the 'reasonableness' and 'performance' components of the expectation-performance gap.

In order for responsibilities to be reasonably expected of auditors, it is logical that their performance should be cost-beneficial. Therefore, some criterion is needed to distinguish those responsibilities which are cost-beneficial for auditors to perform from those that are not. In the absence of formal cost-benefit analysis, for the purposes of the research, following Porter (1993), the responsibilities identified by the auditees and financial community audit beneficiaries as those auditors should perform have been adopted as an acceptable surrogate. The reasoning for this approach lies in the assumption that these two interest groups are fairly familiar with, and informed about, the audit function but from opposing perspectives. Auditees, the subject of auditors' work, are likely to be particularly aware of audit costs and will, therefore, tend towards limiting the responsibilities to be performed by auditors. The financial community group, on the other hand, are beneficiaries of the audit function and, as a result, are more likely to lean towards extending auditors' responsibilities. Thus, the opinions of these two interest groups, one focusing on costs, the other on benefits, may be expected to counter each other so that a cost-benefit consensus may be arrived at. The opinions of the auditor and non-financial community groups are excluded from the surrogate for cost-benefit analysis on the grounds that auditors are too closely involved in the audit function and the non-financial community group is too remote from it.

Based on the measure indicated above (that is, the opinions of the auditees and financial community audit beneficiaries), 23 of the 51 suggested responsibilities of auditors listed in the questionnaire were identified as responsibilities that are reasonable to expect of auditors. These coincide with the responsibilities shown in Table 6.1 as responsibilities auditors should perform. A further responsibility to be included among those that are reasonable to expect of auditors is that of 'examining listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and reporting instances of non-compliance' (2.27bii). Although not meeting the cost-benefit test outlined above, this is an existing responsibility of auditors.

Ascertaining society's expectations of auditors

The mean of responses from an interest group indicating whether a particular responsibility should or should not be performed by auditors, reflects the overall opinion of the group. However, an interest group as a whole may consider that auditors should perform a particular responsibility but some members of the group may hold the contrary opinion. If even one member of an interest group expects auditors to perform a responsibility and they fail to do so, this leaves unfulfilled expectations that contribute to the audit expectation-performance gap. Nevertheless, the problem needs to be kept in proportion: if only one individual's expectations of auditors are not fulfilled, the resulting adverse consequences are unlikely to be sufficiently serious to be of concern to the profession. However, if a significant proportion of an interest group expects auditors to perform a particular responsibility and they fail to do so, criticism may ensue which is sufficiently widespread to damage the profession's reputation and/or to undermine confidence in its work. This is especially the case if a significant proportion of the society group (representing all non-auditors)[2] consider that a particular responsibility should be performed by auditors and they do not do so. As for selecting a measure to delineate perceived deficient performance (see Chapter 5), while acknowledging the arbitrariness of any point measure used to define 'a significant proportion', the researchers consider that if 20% or more of the society group are of the view that a responsibility should be performed by auditors, it warrants further examination to ascertain whether it is (or is not) a responsibility which is reasonable to expect of auditors. Thus, all of the suggested responsibilities listed in the questionnaire identified by 20% or more of the society group as responsibilities auditors should perform, are deemed to constitute 'society's expectations of auditors' (the right boundary of the audit expectation-performance gap depicted in Figure 2.1).

Upon analysis of the society group's responses, it was found that all of the respondents who signified that the responsibility: 'for listed company auditees, to examine compliance with a *specified set* of the Stock Exchange's corporate governance requirements and to report whether or not they have complied with those requirements' (2.27bi) should be a responsibility of auditors, similarly indicated that the broader responsibility ['for listed company auditees, to examine compliance with *all* of the Stock Exchange's corporate governance requirements and to report whether or not they have complied with those requirements' (2.27ai)] should be a responsibility of auditors. Given that the latter subsumes the former, for the purposes of ascertaining the constitution of the audit expectation-performance gap, responsibility 2.27bi is treated as a subset of 2.27ai. This leaves 50 rather than 51 suggested responsibilities of auditors to be investigated further.

Reasonableness gap component of the audit expectation-performance gap

From the column in Table 6.1 headed 'Society Group', it may be seen that 46 of the 50 suggested responsibilities of auditors qualify for further consideration. Just four responsibilities were identified by less than 20% of the society group as responsibilities auditors should perform, namely:

- to examine and report (in the audit report) on the auditee's impact on its local community and environment, and on its non-financial performance (responsibilities 2.24a, 2.24b and 2.20, respectively); and
- to examine evidence to verify every transaction entered into by the auditee (2.25).

Of the 46 responsibilities qualifying for examination to ascertain whether they are – or are not – responsibilities which are reasonable to expect of auditors, 23 are found to fall into the latter category: they are not existing responsibilities of auditors, nor do they meet the cost-benefit test explained above. These include all 28 of the responsibilities shown in Table 6.1 as responsibilities auditors should not perform excluding auditors' existing responsibility: 'for listed company auditees, to examine compliance with a specified set of the Stock Exchange's corporate governance requirements and to report instances of non-compliance (2.27bii), and the four responsibilities that fall outside the set of responsibilities comprising society's expectations of auditors (2.24a, 2.24b, 2.20 and 2.25; see above). These 23 responsibilities constitute the 'reasonableness gap' component of the audit expectation-performance gap.

Reviewing the 23 'reasonableness gap' duties, they seem to fall into two groups: those whose failure to meet the cost-benefit criterion is not difficult to explain and those which might have been expected to qualify as 'responsibilities reasonably expected of auditors'.

Responsibilities unreasonably expected of auditors – readily explainable

The responsibilities whose failure to meet the cost-benefit criterion is readily explainable include the suggested duties: 'to prepare the auditee's financial statements' (2.1) and 'to guarantee that the auditee's financial statements are completely accurate' and that 'an auditee whose financial statements have an unqualified audit report is financially sound' (2.2 and 2.4). If auditors were required to prepare (as well as audit) their auditees' financial statements, this would undermine the purpose of the audit, that is, to provide an expert and independent examination of the auditee's financial statements and an independent opinion based on that examination (Limperg, as reproduced in Limperg Instituut, p. 16). Similarly, it is clearly not economically feasible for auditors to perform an audit so as to be in a position to *guarantee* the complete accuracy of the auditee's financial statements and/or its financial soundness. To do so would require auditors to examine every transaction of the auditee; this would result in prohibitive audit costs without commensurate benefits and, even then, it is unlikely that auditors could be certain that nothing had been overlooked and no errors had occurred so as to be able to *guarantee* the auditee's financial soundness and/or the complete accuracy of its financial statements. It should be of concern to the auditing profession that such expectations of auditors were held by 45% of the society group in respect of responsibility 2.4, and by 37% and 26%, respectively, for responsibilities 2.2 and 2.1.

Three other responsibilities whose failure to meet the cost-benefit test may be readily explained relate to detecting and reporting (to an appropriate authority and/or in the audit report) minor (other than petty) theft of auditee assets by non-managerial employees (2.9a, 2.11a, and 2.12a). It is generally accepted that auditee managements have a responsibility to establish internal control systems, *inter alia*, to prevent and detect theft of the organisation's assets. Auditors have an existing responsibility to detect *material* theft of assets by non-managerial employees which escapes the internal control net but, providing they report such theft to the auditee's management, that is generally where their existing responsibility ends (Porter, 1997). To require auditors to detect and report (to an appropriate authority and/or in the audit report) *minor* theft of corporate assets by non-managerial employees would involve (possibly substantial) additional audit work and may also impact adversely on auditor-client relations. It seems likely that these added costs would outweigh the benefits that might ensue from auditors performing the additional responsibilities.

'To detect minor (other than petty) theft of auditee assets by the directors or senior management' (responsibility 2.9b) and 'to detect illegal acts committed by these parties that only indirectly impact on the auditee's financial statements (such as breaches of occupational safety and environmental laws and regulations)' (2.14b), are further suggested responsibilities of auditors that fail to meet the cost-benefit test. Some commentators contend that such acts by senior officials, even if they involve only small amounts, 'go to the very integrity of management [and] the public has the right to know of this behaviour. … [A]s an agent of society, the auditor has a responsibility to bring to light those things that are considered wrong by society' (Davidson, 1975, pp. 48-49). However, it seems that this view is not generally shared by auditees and financial community audit beneficiaries – interest groups that may be assumed to be sufficiently familiar with the audit function to be broadly aware of the attendant costs and benefits. It could well be that these groups consider that if auditors were required to detect minor theft of auditee assets and illegal acts which do not directly affect the financial statements (which may be perceived to be somewhat distant from the auditor's expertise and the focus of audit work), the additional audit time and cost involved would not be matched by an equivalent (or greater) increment in benefits.

The failure of two duties: 'to report *privately to an appropriate authority* (such as the SFO, police or DTI) if during the audit it is discovered that theft of a significant amount has been committed by non-managerial employees' (2.11b) and 'to examine listed company auditees' compliance with all of the Stock Exchange's corporate governance requirements and to report *instances of non-compliance*' (2.27aii), to qualify as duties reasonably expected of auditors can be readily explained by alternative – more demanding – responsibilities qualifying as cost-effective. The duties: 'to disclose the fact *in the published audit report* if during the audit it is discovered that theft of a significant amount has been committed by non-managerial employees' (2.12b) and 'to examine listed company auditees' compliance with all of the Stock Exchange's corporate governance requirements and to report *whether or not it has complied with those requirements*' (2.27ai), are adjudged to be responsibilities that are reasonably expected of auditors. It seems that the society group considers it is cost-effective for auditors to be required to report material theft of corporate assets by non-managerial employees discovered during the audit in the audit report (a publicly available document) but it is unreasonable to require them also to report such theft privately to an appropriate authority. Such additional reporting would appear to provide little in the way of additional benefits. Similarly, it seems that the society group considers it reasonable to expect auditors to report on listed company auditees' compliance (or otherwise) with the Stock Exchange's corporate governance requirements rather than merely reporting instances of non-compliance.

Auditing half-yearly and quarterly published financial statements (responsibilities 2.22a and 2.22b) are two further responsibilities not qualifying as reasonable to expect of auditors. It may be that, although the audit costs involved can be estimated from the audit fees disclosed in the annual financial statements (and may be perceived to be high), the benefits to be derived from auditors performing these duties are more difficult to gauge – and may be seen as relatively limited. Given that their annual financial statements are subject to a full audit, it seems unlikely that auditees will stray too far from a 'true and fair view' in their interim financial statements. If they do so, it is likely that their deviation will be detected and will prompt demands for explanations from interested parties who use the documents. Hence, it seems likely that the costs involved in auditing half-yearly or quarterly financial statements would not generate commensurate benefits.

Responsibilities unreasonably expected of auditors – less readily explainable

A somewhat puzzling finding of the research is the failure to meet the cost-benefit criterion of the responsibility: 'to disclose in the audit report illegal acts by the auditee's directors or senior management that only indirectly impact on the auditee's financial statements (such as breaches of occupational safety and environmental laws and regulations) which are discovered during the audit' (2.15b). If, during the course of an audit, auditors detect such illegal acts by the auditee's executives, it seems strange that it is not adjudged reasonable for auditors to disclose the information in the audit report – even if the acts concerned do not directly impact the financial statements. As noted above, such acts reflect the integrity of the auditee's senior officials and, intuitively, it might be thought that the benefits of disclosing such information to external parties interested in the auditee would outweigh the (apparently) minimal additional audit costs involved in such reporting. It may be that potential legal and reputational costs for the auditors (arising, for example, from possible claims by the officials for defamation of character), and/or the cost of disruption within the auditee that may result from such disclosure, are considered by the society group to outweigh the potential social benefits to be gained.

Given the apparent interest in – and demand for[3] – greater corporate social responsibility, increased recognition of the importance of non-financial performance measures and the reporting thereof (for example, Eccles, Herz, Keegan and Phillips 2001), and the increasing use of the internet to disclose organisations' financial (and non-financial) information, it might be expected that assurance about the reliability (or audit) of such information would meet the cost-benefit criterion. However, none of the following responsibilities qualify as responsibilities that are reasonable to expect of auditors:

- to examine and report (in the audit report) on the reliability of information in the auditee's entire annual report – and, more particularly, about its equal employment opportunities policy and record, its product safety policy and record, and its occupational health and safety policy and record (responsibilities 2.26a, 2.17a, 2.17b and 2.17c, respectively);
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet' (2.30).

Similar remarks apply to the responsibilities: 'to examine and report (in the audit report) on the auditee's computer systems, the effectiveness of its internal non-financial controls, the efficiency and effectiveness of its management and administration, and the adequacy of its procedures for identifying and managing its risk exposures' (responsibilities 2.19, 2.18b, 2.21 and 2.29, respectively). Organisations are increasingly dependent on their computer systems for all aspects of their current operations and future strategic and financial planning. Additionally, to some extent in all organisations but especially in listed companies, increased emphasis has been (and is being) placed on internal non-financial (as well as financial) internal controls, and on procedures for identifying and managing risks. Indeed, these factors have been explicitly recognised in the corporate governance reports whose recommendations underlie the Stock Exchange's governance requirements [for example, those of the Committee on the Financial Aspects of Corporate Governance, 1992 (Cadbury Committee); the Committee on Corporate Governance, 1998 (Hampel Committee); and the Institute of Chartered Accountants in England and Wales (ICAEW), 1999, (Turnbull Report)]. Further, the increasingly competitive, complex and dynamic nature of the current commercial environment has prompted greater need for efficient and effective corporate management. Hence, in respect of all of these matters, external auditors' assurance might be 'reasonably expected'. Nevertheless none of these four responsibilities (*ie*. 2.19, 2.18b, 2.21 and 2.29) met the research's cost-benefit test.

This finding may result from the fact that these issues are still relatively new and the beneficial role that auditors could play by providing assurance in these regards has not yet been widely recognised. It could be that in – say – five years' time such responsibilities will be adjudged as 'reasonable to expect of auditors' (especially if a catastrophe caused by a failure of one or more of these factors occurs!). However, it may also be that the society group has yet to recognise that auditors are capable of providing valuable assurance on such matters and that they perceive auditors' role (and expertise) as limited to expressing an opinion on auditees' financial statements. Such a perception may have been enhanced by the apparent reluctance by the auditing profession to accept extended responsibilities and to broaden their role and function in society. (This reluctance is reflected in the limited number and scope of responsibilities the auditor group identified as those they should perform: see Table 6.1). It is likely that their reluctance can be traced, at least in part (according to comments made during interviews with partners in some of the large audit firms), to auditors' fears of increased exposure to legal liability.

A further responsibility that failed to meet the cost-benefit test is that of 'reporting to the Inland Revenue breaches of tax law discovered during an audit' (2.7) – a finding that is rather perplexing. This responsibility falls within auditors' domain of expertise and, given that the tax information provided in the financial statements must be audited, the performance of this responsibility would seem to involve little additional audit cost. Further, some benefit could be expected to ensue in terms of increased government revenues for social spending. However, in the UK (as in other countries) there appears to be fairly widespread antipathy towards the Inland Revenue and a sense that tax avoidance is, in general, socially acceptable behaviour. It thus appears that the main costs involved in auditors performing this responsibility lie in the adverse impact it would have on auditor-client relations – resulting, perhaps, in reduced client co-operation and, therefore, in increased auditor time and cost. On balance, the social and economic costs attaching to auditors performing this duty may be perceived to outweigh the social and economic benefits likely to be gained.

Deficient standards gap component of the audit expectation-performance gap

It was noted in the introduction to this chapter (and depicted in Figure 2.1 in Chapter 2), that 'the responsibilities reasonably expected of auditors' constitute the boundary between the reasonableness and performance gap portions of the audit expectation-performance gap. It was also explained in chapter two that the performance gap may be sub-divided into the deficient performance gap (discussed in Chapter 5) and the deficient standards gap. It is to this latter component of the audit expectation-performance gap that attention is now turned.

As noted earlier in this chapter, of the 46 responsibilities identified by 20% or more of the society group as responsibilities auditors should perform, 23 failed the cost-benefit test. These responsibilities constitute 'the reasonableness gap' component of the audit-expectation performance gap. Of the remaining 23 responsibilities, 13 are existing responsibilities of auditors (see Chapter 4) and the other ten are reasonably expected but not (yet) required of auditors. These ten duties constitute 'the deficient standards gap' (see Figure 2.1). If auditors' performance is to be aligned with society's expectations, auditing standards need to be extended to encompass these duties. They are as follows:

- where the auditor has doubts about the continued existence of an auditee, to report such doubts privately to an appropriate authority such as the DTI or Financial Services Authority (2.5a);
- in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority such as the SFO, police or DTI, if during an audit it is discovered that information in the auditee's financial statements has been deliberately distorted, or if suspicious circumstances are encountered that suggest theft or deliberate distortion of the financial statements may have occurred (2.11d and 2.13);
- to disclose the fact in the audit report if during an audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees or by the auditee's directors or senior management, or that the latter parties have committed other illegal acts which directly impact on the financial statements (such as bribery or political payoffs) (2.12b, 2.12c, 2.15a);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls and the reasonableness of financial forecasts included in its annual report (2.18a, and 2.23);

- to examine compliance with all of the Stock Exchange's corporate governance requirements and to report whether or not the auditee has complied with those requirements (2.27ai); and
- to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing the auditee's risk exposures (2.28).

Reviewing these responsibilities, it may be seen that six of the ten involve disclosing in the audit report, or to an appropriate authority, matters of concern that are discovered during an audit (that is, responsibilities 2.5a, 2.11d, 2.12b, 2.12c, 2.13 and 2.15a). The information to be disclosed is already within the auditor's knowledge and it appears that extending auditors' duties to embrace these reporting requirements would result in little additional audit cost. It seems likely that these costs would be more than outweighed by the benefits to society that would ensue. However, before these responsibilities are imposed on auditors, clarification is needed as to the 'appropriate authority' to which auditors should report, and legal protection needs to be provided for auditors against possible claims of breach of client confidentiality and, in some cases, defamation of character, when they report matters of concern in good faith and on reasonable grounds.

A further three of the ten duties relate to corporate governance issues. As noted earlier, one of these (2.27ai) is preferred by the survey respondents to auditors' existing responsibility; in place of examining auditees' compliance with the Stock Exchange's corporate governance requirements and merely reporting instances of non-compliance, respondents signified that auditors should be required to report on auditees' compliance (or otherwise) with the Stock Exchange's corporate governance requirements. The other two 'corporate governance responsibilities' concern examining and reporting on the effectiveness of the auditee's internal financial controls and on the adequacy of procedures for identifying and managing its risk exposures (2.18a and 2.28). These matters have figured prominently in key corporate governance reports [for example, the Hampel Report, 1998; and Turnbull Report, 1999). Although auditors are not required to perform these responsibilities under existing auditing standards, it is evident their inclusion among their responsibilities would be generally supported by auditors' interest groups (that is, by auditees and financial and non-financial community audit beneficiaries).

Although not in the media spotlight, recognition of 'examining and reporting on the reasonableness of financial forecasts included in the auditee's annual report' (responsibility 2.23) as a responsibility reasonably expected of auditors accords with the attention given by the UK's Accounting Standards Board (and equivalent standard setting bodies elsewhere) to developing standards that enhance the value of financial statements for economic decision making. Emphasis is increasingly being placed on future-oriented, rather than historic, financial information. In this context, financial forecasts are clearly beneficial. However, their credibility – and hence their value – would be significantly increased if external auditors examined and reported on their reasonableness (or otherwise). Such a responsibility falls within the ambit of the auditor's expertise and, although such a responsibility is likely to involve additional audit work, the survey findings indicate that the costs would be outweighed by the resulting benefits. However, before requiring auditors to perform this responsibility, guidelines are needed on how auditors should evaluate, and users of their reports should interpret, the 'reasonableness' of financial forecasts. Although the Auditing Practices Board in the UK has not issued an Auditing Standard on auditing of financial forecasts, guidance for auditors has been provided in International Standards on Auditing (ISA) 810*: The Examination of Prospective Financial Information*.

Summary and key issues

This chapter has identified the responsibilities the survey groups indicated auditors should perform. Their responses provided the basis for ascertaining society's expectations of auditors, the responsibilities it is reasonable to expect auditors to perform, and the constituents of the 'reasonableness' and 'deficient standards' components of the audit expectation-performance gap.

It has been shown that the survey findings with respect to the responsibilities auditors' interest groups consider auditors should perform are intuitively as might be expected: the auditor group recognised the smallest number of responsibilities as those they should be required to perform, the audit beneficiaries – and, in particular, the non-financial community group – identified the greatest number. Additionally, the level of agreement among the interest groups regarding the duties auditors should perform was, in general, least among the auditors and greatest among the audit beneficiaries (more specifically, among the non-financial community group).

Using the measure of 20% or more of the society group (that is, all non-auditors) signifying that a responsibility should be performed by auditors, it was found that 46 of the responsibilities listed in the questionnaire[4] constituted 'society's expectations of auditors' (the right boundary of the audit expectation-performance gap). Similarly, using the combined responses of the auditees (who could be expected to focus on audit costs) and the financial community audit beneficiaries (who could be expected to focus principally on benefits to be derived from an audit) as a surrogate for cost-benefit analysis, 23 responsibilities were identified as those that it is reasonable to expect auditors to perform. These responsibilities constitute the boundary between the 'reasonableness gap' and 'performance gap' components of the audit expectation-performance gap.

Further analysis revealed that the 23 responsibilities comprising the 'reasonableness gap' (that is, the responsibilities society expects auditors to perform but which do not meet the cost-benefit criterion) fall into two broad groups – those whose failure to meet the cost-benefit test is fairly easy to explain (for example, the expectation that auditors should prepare, as well as audit, their auditees' financial statements) and those whose failure to meet the cost-benefit test is more perplexing (for example, the expectation that auditors will report breaches of tax law they discover during an audit to the Inland Revenue).

The 'deficient standards' portion of the 'performance gap' lies on the other side of the boundary comprising responsibilities 'reasonably expected of auditors' to the 'reasonableness gap' (see Chapter 2, Figure 2.1). It consists of the ten responsibilities that are reasonable to expect of auditors but are not required of them under current auditing standards (the remaining 13 responsibilities that are reasonable to expect of auditors are existing responsibilities of auditors). The responsibilities constituting the 'deficient standards gap' largely revolve around reporting (in the audit report or to an appropriate authority) information about matters of concern (such as theft or other illegal acts committed by personnel within the auditee), or doubts about the ability of the auditee to continue as a going concern, that is within the auditors' knowledge. If auditors' responsibilities are to be aligned with society's reasonable expectations of them, auditing standards need to be extended to encompass these responsibilities.

Key findings of this portion of the research include the following:

- The greater the distance of the survey groups from the audit process, the greater the number and range of responsibilities they expect auditors to perform. It seems that non-financial community audit beneficiaries (the group most remote from the audit function) expect auditors to fulfil a very broad role in society.
- Forty six responsibilities were identified as constituting 'society's expectations of auditors'.
- Of the 46 responsibilities society expects auditors to perform, based on the application of a cost-benefit criterion, 23 are reasonable to expect of auditors.
- Thus, 23 responsibilities included among 'society's expectations of auditors' are unreasonably expected of auditors as they are not cost-beneficial for auditors to perform. These responsibilities comprise the 'reasonableness gap' component of the audit expectation-performance gap.
- Of the 23 responsibilities which it is reasonable to expect of auditors, 13 are their existing responsibilities; the remaining ten are reasonably expected but not currently required of them. These ten responsibilities constitute the 'deficient standards gap' component of the audit expectation-performance gap.

Endnotes:

1 See chapter five, endnote two.

2 See chapter five, endnote two.

3 As evidenced by the increased incidence and extent of reporting by major companies in their in annual or stand-alone reports on their corporate social responsibility and related activities.

4 As explained in the text, responsibility 2.27bi was subsumed by 2.27ai and, as a result, 50 rather than 51 responsibilities were subject to further examination to ascertain whether or not they were an element of 'society's expectations of auditors'.

CHAPTER SEVEN

AUDIT EXPECTATION-PERFORMANCE GAP IN THE UNITED KINGDOM IN 1999 AND IN NEW ZEALAND IN 1989

In this chapter the survey results discussed in earlier chapters of this report are summarised and presented diagrammatically. Additionally, it was noted in chapter one that the current research replicates Porter's study in New Zealand (NZ) in 1989 (reported in Porter, 1993). It is therefore pertinent to compare the audit expectation-performance gap as it was found to exist in the UK in 1999 with that pertaining in NZ in 1989. As the legal, commercial and socio-economic environments of the UK and NZ are very similar, this comparison provides useful insight into how the gap has changed over the decade from 1989 to 1999.

Composition of the audit expectation-performance gap in the UK in 1999

It was shown in chapter two (and depicted in Figure 2.1) that the audit expectation-performance gap has two major components – the 'reasonableness gap' and the 'performance gap' – and that the latter component may be sub-divided into the 'deficient standards' and the 'deficient performance' gaps.

In chapter six it was explained that two key boundaries of the audit expectation-performance gap are 'society's expectations of auditors' and 'responsibilities reasonably expected of auditors'. It was also shown that, based on the responses of the society group (*ie.* all non-auditor respondents), 46 of the responsibilities listed in the survey instrument were identified as constituting 'society's expectations of auditors'. These 46 responsibilities, which form the right boundary of the audit expectation-performance gap, are denoted 'S' in Table 7.1 in the column headed 'Duties expected of auditors'. Applying a cost-benefit test (derived from the responses of the auditees and financial community audit beneficiaries signifying the responsibilities auditors should perform), it was found that 23 of the 46 responsibilities society expects of auditors qualify as responsibilities that are reasonable to expect of auditors. These 23 responsibilities, which form the boundary between the 'reasonableness gap' and 'performance gap' (or, more specifically, the 'deficient standards' portion of the 'performance gap'), are denoted 'RE' in Table 7.1 in the column headed 'Duties reasonably expected of auditors'. The remaining 23 responsibilities (*ie.* those that did not meet the cost-benefit criterion) constitute the 'reasonableness gap'.

It was further explained in chapter six that, of the 23 responsibilities that are reasonably expected of auditors, 13 are existing responsibilities of auditors and that the remaining ten (those that are reasonably expected but not currently required of auditors) comprise the 'deficient standards' portion of the 'performance gap'.

Another significant boundary within the audit expectation-performance gap is that of auditors' existing duties. This is constituted by the 13 existing responsibilities of auditors listed in the questionnaire and forms the boundary between the 'deficient standards' and 'deficient performance' components of the 'performance gap'. These responsibilities are denoted 'D' in Table 7.1 in the column headed 'Existing duties of auditors'. In chapter five it was shown that the society group adjudged auditors' performance of seven of their 13 existing responsibilities to be sub-standard. These seven responsibilities form the 'deficient performance' portion of the 'performance gap'.

The various components of the audit expectation-performance gap outlined above are presented diagrammatically in Figure 7.1

Table 7.1 Contribution of responsibilities to components of the audit expectation-performance gap, UK 1999

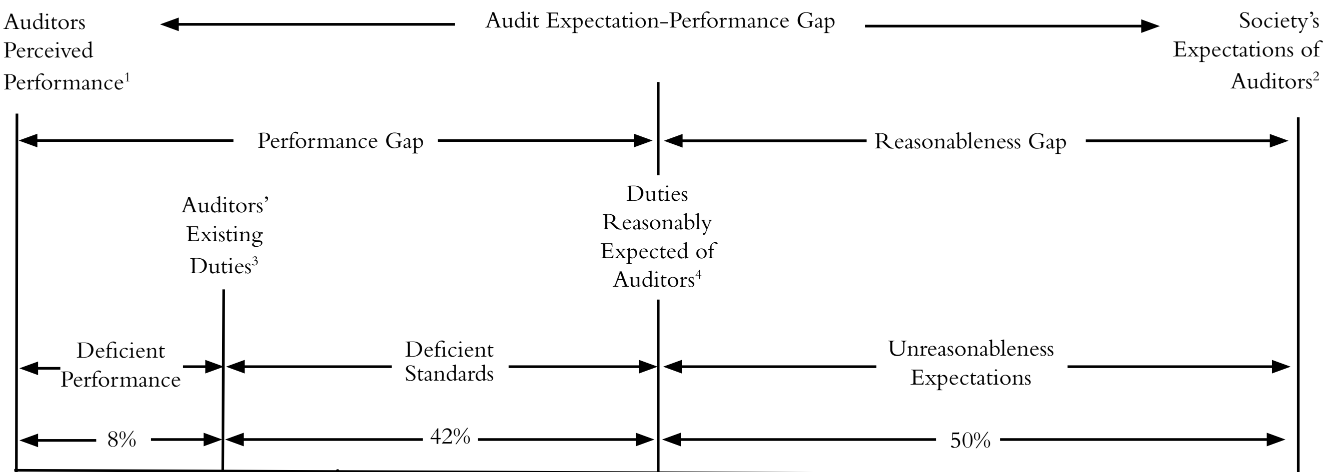
Resp. No.		Deficient perform-ance gap duties	Existing duties of auditors	Deficient standards gap duties	Duties reasonably expected of auditors	Reason-ableness gap duties	Duties expected of auditors
	***Suggested responsibilities of auditors*[1]**	%[2]		%[2]		%[2]	
2.1	Prepare auditee's financial statements	–	–	–	–	26	S
2.2	Guarantee auditee's financial statements are accurate	–	–	–	–	37	S
2.3	State whether auditee's financial statements fairly reflect its financial affairs	–	D	–	RE	–	S
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	–	–	–	–	45	S
2.5a	Report to an appropriate authority (*eg* DTI or FSA) doubts about the auditee's continued existence	–	–	53	RE	–	S
2.5b	Disclose in the audit report doubts about auditee's continued existence	23	D	–	RE	–	S
2.6	Ensure compliance with relevant legislation	–	D	–	RE	–	S
2.7	Report breaches of tax law to Inland Revenue	–	–	–	–	48	S
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	21	D	–	RE	–	S
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	22	D	–	RE	–	S
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	27	S
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	–	–	–	–	34	S
2.10	Detect deliberate distortion of auditee's financial statements	–	D	–	RE	–	S
2.11a	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	25	S
2.11b	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), theft of material amount of auditee's assets by non-managerial employees	–	–	–	–	53	S
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of auditee's assets by directors/senior management	13	D	–	RE	–	S
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), deliberate distortion of auditee's financial statements	–	–	75	RE	–	S
2.12a	Disclose in the audit report minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	23	S
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	–	–	64	RE	–	S
2.12c	Disclose in the audit report embezzlement of auditee's assets by directors/senior management		–	82	RE	–	S
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	17	D	–	RE	–	S
2.13	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) suspicions of theft or deliberate distortion of auditee's financial statements	–	–	62	RE	–	S
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	18	D	–	RE	–	S
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)		–	–	–	33	S
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on auditee's financial statements		–	79	RE	–	S
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	–	–	–	–	36	S

2.16	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts committed by auditee's officials	17	D	-	RE	-	S
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	-	-	-	-	20	S
2.17b	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its product safety policy and record	-	-	-	-	21	S
2.17c	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its occupational health and safety policy and record	-	-	-	-	21	S
2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its directors/senior executives' remuneration policy and record	-	D	-	RE	-	S
2.18a	Examine and report (in the audit report) on the effectiveness of auditee's internal financial controls	-	-	79	RE	-	S
2.18b	Examine and report (in the audit report) on the effectiveness of auditee's internal non-financial controls	-	-	-	-	41	S
2.19	Examine and report (in the audit report) on auditee's IT systems	-	-	-	-	34	S
2.20	Examine and report (in the audit report) on auditee's non-financial performance	-	-	-	-	-	-
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	-	-	-	-	25	S
2.22a	To audit half-yearly published financial statements	-	-	-	-	46	S
2.22b	To audit quarterly published financial statements	-	-	-	-	23	S
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	-	-	53	RE	-	S
2.24a	Consider and report (in audit report) on the impact of auditee on its local community	-	-	-	-	-	-
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	-	-	-	-	-	-
2.25	Verify every transaction of the auditee	-	-	-	-	-	-
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	-	-	-	-	49	S
2.26b	Examine and report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements	-	D	-	RE	-	S
2.27ai	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	-	-	51	RE	-	S
2.27aii	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-	-	-	-	39	S
2.27bi	For listed company auditees, examine compliance with specified set of Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	*Subsumed by 2.27ai (All non-auditors indicating auditors should perform 2.27bi also answered 'yes' to 2.27ai)*					
2.27bii	For listed company auditees, examine compliance with specified set of Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-	D	–	RE	-	S
2.28	Examine and report to auditee's directors (or equivalent) on adequacy of auditee's risk management procedures	-	-	68	RE	-	S
2.29	Examine and report (in the audit report) on the adequacy of auditee's risk management procedures	-	-	-	-	45	S
2.30	Examine and report (in attached audit report) on reliability of auditee's financial information on the Internet	-	-	-	-	43	S
No. of responsibilities		7	13	10	23	23	46
Measure of unfulfilled expectations attaching to component		131	-	666	-	794	-
Proportion of expectation-performance gap		8%	-	42%	-	50%	-

1.	The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
2	Percentage of non-auditor respondents signifying the responsibility is poorly performed, or that the responsibility should be performed by auditors as applicable.
D	Existing duty of auditors, identified by reference to Statute law, Case law and professional promulgations.
RE	Responsibilities expected of auditors which are cost-beneficial for auditors to perform.
S	Responsibility identified by 20% or more of the society group as a responsibility auditors should perform.

Figure 7.1 The relative contribution of duties to components and oc components to the audit expectation-performance gap in UK, 1999

(Please note: The key to duties identified by number is presented in Table 7.1



Duty	Response %[5]	Contrib %[6]	Duty	Response %[5]	Contrib %[6]	Duty	Response %[5]	Contrib	Duty	Response %[5]	Contrib %[6]
2.5b	23	17	2.12c	82	12	2.11b	53	7	2.9b	34	4
2.8b	22	17	2.15a	79	12	2.26a	49	6	2.14b	33	4
2.8a	21	16	2.18a	79	12	2.7	48	6	2.9a	27	3
2.14a	18	14	2.11d	75	11	2.22a	46	6	2.1	26	3
2.16	17	13	2.28	68	10	2.29	45	6	2.11a	25	3
2.12d	17	13	2.12b	64	10	2.4	45	6	2.21	25	3
2.11c	13	10	2.13	62	9	2.30	43	5	2.22b	23	3
			2.5a	53	8	2.18b	41	5	2.12a	23	3
			2.23	53	8	2.27aii	39	5	2.17b	21	3
			2.27ai	51	8	2.2	37	5	2.17c	21	3
						2.15b	36	5	2.17a	20	2
						2.19	34	4			
	131	**100**		**666**	**100**					**794**	**100**

1 Auditors' duties perceived by the society group to be performed deficiently.
2 Duties expected of auditors by 20% or more of a non-auditor interest group.
3 Existing duties defined by reference to the statute law, case law and professional promulgations.
4 Duties which are cost-beneficial for auditors to perform.
5 Proportion of the society group (non-auditor respondents) whose expectations with respect to the duty are not being fulfilled.
6 Relative contribution of duties to the component.

Extent of the audit expectation-performance gap and its components in the UK in 1999

In addition to identifying the structure and composition of the audit expectation-performance gap, the research enabled an estimate to be made of the relative contribution of each responsibility to its component, and of each component to the overall audit expectation-performance gap. Members of the society group who indicated that a particular responsibility, not currently performed by auditors, should be performed, and those who signified that auditors perform an existing responsibility poorly, have expectations of auditors that are not fulfilled. Thus, a measure of society's unfulfilled expectations attaching to each responsibility contributing to the 'reasonableness', 'deficient standards' and 'deficient performance' components of the audit expectation-performance gap may be derived from the proportion of the society group who indicated that a responsibility not currently required of auditors should be performed, or an existing duty is performed poorly. (The relevant proportions are shown in Table 7.1 in the columns headed 'Reasonableness gap duties', 'Deficient standards gap duties' and 'Deficient performance gap duties', respectively.)

In a similar manner, the relative contribution of each component of the audit expectation-performance gap (that is, the 'reasonableness gap' and the 'deficient standards' and 'deficient performance' portions of the 'performance gap') may be obtained by totalling the proportion of society's unfulfilled expectations attaching to each responsibility comprising a component of the audit expectation-performance gap to arrive at a measure of the total unfulfilled expectations attaching to the component. These totals may then be added to obtain a measure of society's unfulfilled expectations that constitute the audit expectation-performance gap. From this, the relative contribution of each component to the overall gap may be calculated. (The relevant totals and relative contributions of each component of the audit expectation-performance gap are shown at the foot of Table 7.1 and in Figure 7.1.)

As may be seen from Figure 7.1, 50% of the audit expectation-performance gap derives from society having unreasonable expectations of auditors, 42% results from auditors not being required to perform duties that are reasonably expected of them, and 8% is accounted for by auditors' deficient performance. It may also be seen (from the respective proportions of the society group whose expectations with respect to the responsibilities are not being fulfilled) that six responsibilities included in the questionnaire account for 37% of the reasonableness gap (and 18% of the total expectation-performance gap). These are the responsibilities:

- to report privately to an appropriate authority if during an audit it is discovered that theft of a material amount of the auditee's assets has been committed by non-managerial employees (2.11b), and to report to the Inland Revenue breaches of tax law discovered during an audit (2.7);
- to examine and report (in the audit report) on the reliability of information contained in the auditee's entire annual report, and on the adequacy of the auditee's procedures for identifying and managing its risk exposures (2.26a and 2.29);
- to audit half-yearly published financial statements (2.22a); and
- to guarantee that an auditee whose financial statements have been given an unqualified audit report is financially sound (2.4).

Similarly, it may be seen that four responsibilities account for 47% of the deficient standards gap (and 20% of the total expectation-performance gap). These are as follows:

- to disclose the fact in the audit report if during the audit is its discovered that the directors or senior management have embezzled auditee assets or committed other illegal acts which directly impact on the financial statements (such as bribery or political payoffs) (2.12c and 2.15a);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a); and
- to report privately to an appropriate authority (such as the SFO, police or DTI) if during the audit it is discovered that information presented in the financial statements has been deliberately distorted (2.11d).

Three other responsibilities similarly account for 50% of the deficient performance gap (and 4% of the total audit expectation-performance gap), namely: to disclose in the audit report doubts about the auditee's continued existence (2.5b), and to detect the theft of a material amount of auditee assets by the organisation's non-managerial employees or by its directors or senior management (2.8a and 2.8b).

Comparison of the composition and extent of the audit expectation-performance gap in the UK in 1999 and in New Zealand (NZ) in 1989

It was noted in the introduction to this chapter that the legal, commercial and socio-economic environments of the UK and NZ are very similar and, as a result, comparing the composition and extent of the audit expectation-performance gap in the UK in 1999 with that pertaining in NZ in 1989 provides useful insight into how the audit expectation-performance gap has changed over the decade from 1989 to 1999. Table 7.2 and Figure 7.2 summarise the findings of Porter's 1989 study of the audit expectation-performance gap in NZ (Porter, 1993). These follow the same format as Table 7.1 and Figure 7.1.

Comparing Figures 7.1 and 7.2, the most striking feature is the change in the relative contribution of the three components (*ie.* the 'reasonableness gap' and the 'deficient standards' and 'deficient performance' portions of the 'performance gap') to the overall audit expectation-performance gap. While the 'reasonableness gap' has increased from 31% to 50%, the 'deficient standards gap' has fallen from 58% to 42%, and the 'deficient performance gap' from 11% to 8% (Thus, the total 'performance gap' been reduced from 69% to 50% of the audit expectation-performance gap).

While auditors' performance appears to have improved significantly over the decade from 1989 to 1999, the resultant narrowing of the expectation-performance gap has been more than offset by an increase in society's (unreasonable) expectations of auditors. Indeed, if the measures of society's unfulfilled expectations (derived as explained earlier in this chapter and shown at the foot of Tables 7.1 and 7.2) are compared, it is found that, despite the narrowing of the performance gap, the audit expectation-performance gap overall has widened from 1,140 units of unfulfilled expectations in 1989 to 1,591 units in 1999 (an increase of 40% – virtually all of which is derived from the widening of the reasonableness gap).

Changes in the composition of the reasonableness gap 1989-1999

All nine of the responsibilities constituting the reasonableness gap in NZ in 1989 reappeared as elements of this component of the audit expectation-performance gap in the UK in 1999 (see Figures 7.1 and 7.2). These include the suggested responsibilities:

- to guarantee that the audited financial statements are completely accurate (2.2) and that an auditee whose financial statements receive an unqualified audit report is financially sound (2.4);
- to report to the Inland Revenue breaches of tax law discovered during an audit (2.7);
- to examine and report (in the audit report) on the efficiency and effectiveness of the auditee's management and administration (2.21); and
- to detect, and to disclose in the audit report, illegal acts committed by the auditee's directors or management which only indirectly impact on the financial statements (such as breaches of occupational safety and environmental laws and regulations (2.14b, 2.15b).

Two responsibilities relating to auditors reporting privately to an appropriate authority if during an audit it is discovered that minor (but not petty) theft, or theft of a significant amount, of auditee assets has been committed by non-managerial employees (responsibilities 2.11a and 2.11b), two others concerning auditors reporting in the audit report if during an audit it is discovered that minor (but not petty) theft, or theft of a significant amount, of auditee assets has been committed by non-managerial employees (2.12a and 2.12b), and four responsibilities relating to auditors examining and reporting in the audit report on the reliability of certain non-financial information contained in auditees' annual reports (2.17a, 2.17b, 2.17c and 2.17d), were each expressed as separate responsibilities in the 1999 survey instrument. However, in the 1989 questionnaire they were combined as single more generally stated responsibilities that did not distinguish between minor and material theft (in the case of responsibilities 2.11 and 2.12), and merely referred to non-financial information – without identifying any types of such information (in the case of responsibility 2.17). The greater detail with which these responsibilities were expressed in 1999, compared with 1989, reflects the increased importance of the issues in the audit environment in both the UK and NZ in 1999.

Table 7.2 Contribution of responsibilities to components of the audit expectation-performance gap, NZ 1989

Resp. No.		Perform-ance gap duties	Existing duties of auditors	Deficient standards gap duties	Duties reasonably expected of auditors	Reason-ableness gap duties	Duties expected of auditors
	Suggested responsibilities of auditors[1]	%[2]		%[2]		%[2]	
2.1	Prepare auditee's financial statements	-	-	-	-	-	-
2.2	Guarantee auditee's financial statements are accurate	-	-	-	-	39	S
2.3	State whether auditee's financial statements fairly reflect its financial affairs	-	D	-	RE	-	S
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	-	-	-	-	41	S
2.5a	Report to an appropriate authority (*eg* Registrar of Cos or Reserve Bank) doubts about auditee's continued existence	-	-	55	RE		S
2.5b	Disclose in the audit report doubts about auditee's continued existence	37	D	-	RE	-	S
2.6	Ensure compliance with relevant legislation	-	D		RE	-	S
2.7	Report breaches of tax law to Inland Revenue Department	-	-	-	-	33	S
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	19	D	-	RE	-	S
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	21	D	-	RE	-	S
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	-	N/A	-	N/A	-	N/A
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	-	N/A	-	N/A	-	N/A
2.10	Detect deliberate distortion of auditee's financial statements	-	D	-	RE	-	S
2.11a/b	In absence of a regulated industry duty to do so, to report to an appropriate authority (*eg* Police or Registrar of Cos), theft of auditee's assets by non-managerial employees	-	-	-	-	51	S
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), embezzlement of auditee's assets by directors/senior management	-	-	74	RE	-	S
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), deliberate distortion of auditee's financial statements	-	-	76	RE	-	S
2.12a/b	Disclose in the audit report theft of auditee's assets by non-managerial employees	-	-	-	-	47	S
2.12c	Disclose in the audit report embezzlement of the auditee's assets by directors/senior management	-	-	70	RE	-	S
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	27	D	-	RE	-	S
2.13	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) suspicions of theft or deliberate distortion of auditee's financial statements	-	-	60	RE	-	S
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	21	D	-	RE	-	S
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-	-	-	-	40	S

2.15a	Disclose in audit report illegal acts by auditee's officials which directly impact on auditee's financial statements	–	–	68	RE	–	S
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	–	–	–	–	40	S
2.16	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) illegal acts committed by auditee's officials	–	–	64	RE	–	S
2.17a/ b/c/d	Examine and report (in audit report) on reliability of non-financial information presented in auditee's annual report	–	–	–	–	32	S
2.18a	Examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls	–	–	75	RE	–	S
2.18b	Examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls	–	N/A	–	N/A		N/A
2.19	Examine and report (in the audit report) on auditee's IT systems	–	N/A	–	N/A		N/A
2.20	Examine and report (in the audit report) on auditee's non-financial performance	–	N/A	–	N/A	–	N/A
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	–	–	–	–	25	S
2.22a	To audit half-yearly published financial statements	–	–	62	RE	–	S
2.22b	To audit quarterly published financial statements	–	N/A	–	N/A	–	N/A
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	–	–	63	RE	–	S
2.24a	Consider and report (in audit report) on the impact of auditee on its local community	–	–	–	–	–	–
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	–	N/A	–	N/A	–	N/A
2.25	Verify every transaction of the auditee	–	–	–	–	–	–
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	–	N/A	–	N/A	–	N/A
2.26b	Examine and report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements	–	N/A	–	N/A	–	N/A
2.27a/ b	For listed company auditees, examine compliance with Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	–	N/A	–	N/A	–	N/A
2.28	Examine and report to auditee's directors (or equivalent) on adequacy of auditee's risk management procedures	–	N/A	–	N/A	–	N/A
2.29	Examine and report (in the audit report) on the adequacy of auditee's risk management procedures	–	N/A	–	N/A	–	N/A
2.30	Examine and report (in attached audit report) on reliability of auditee's financial information on the Internet	–	N/A	–	N/A	–	N/A
No. of responsibilities		5	8	10	18	9	27
Measure of unfulfilled expectations attaching to component		125	–	667	–	348	–
Proportion of expectation-performance gap		11%		58%		31%	

1 The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
2 Percentage of non-auditor respondents signifying the responsibility is poorly performed, or that the responsibility should be performed by auditors, as applicable.
D Existing duty of auditors, identified by reference to Statute law, Case law and professional promulgations.
RE Responsibilities expected of auditors which are cost-beneficial for auditors to perform.
S Responsibility identified by 20% or more of the society group as a responsibility auditors should perform.
N/A Responsibility included in the 1999, but not in the 1989, questionnaire

Figure 7.2 ***The relative contribution of duties to components and of components to the audit expectation-performance gap in NZ, 1989***
(Please note: The key to responsibilities identified by number is presented in table 7.2)[7]

Auditors Perceived Performance[1] ← Audit Expectation-Performance Gap → Society's Expectations of Auditors[2]

← Performance Gap → | ← Reasonableness Gap →

Auditors' Existing Responsibilities[3]

Responsibilities Reasonably Expected of Auditors[4]

← Deficient Performance → | ← Deficient Standards → | ← Unreasonableness Expectations →

← 11% → | ← 58% → | ← 31% →

Duty	Response %[5]	Contrib %[6]	Duty	Response %[5]	Contrib %[6]	Duty	Response %[5]	Contrib %[6]
2.5b	37	30	2.11d	76	11	2.11a/b	51	152
2.12d	27	21	2.18a	75	11	2.12a/b	47	14
2.8b	21	17	2.11c	74	11	2.4	41	12
2.14a	21	17	2.12c	70	11	2.14b	40	11
2.8a	19	15	2.15a	68	10	2.15b	40	11
			2.16	64	10	2.2	39	11
			2.23	63	10	2.7	33	10
			2.22a	62	9	2.17a/b/c/d	32	9
			2.13	60	9	2.21	25	7
			2.5a	55	8			
	125	**100**		**667**	**100**		**348**	**100**

1 Auditors' responsibilities perceived by the 'society' interest groups (auditees, financial and non-financial community audit beneficiaries) to be performed deficiently.
2 Responsibilities expected of auditors by 20% or more of a non-auditor interest group.
3 Existing responsibilities defined by reference to the statute law, case law, quasi-government regulations and professional promulgations.
4 Responsibilities that are cost-beneficial for auditors to perform.
5 Average of the proportions of the 'society' interest groups whose expectations with respect to the responsibility are not being fulfilled. (Using the average eliminates the effect of different sample sizes)
6 Relative contribution of responsibilities to the component.
7 The numbers of the responsibilities used in the NZ 1989 survey have been amended to correspond with those used for the relevant responsibilities in the UK 1999 survey.

In NZ in 1989, responsibilities 2.11, 2.12 and 2.17 (see above) each contributed to the reasonableness gap. In the UK in 1999, the corresponding, more detailed responsibilities also featured as elements of the reasonableness gap with the exception of the following:

- to disclose the fact in the audit report if during the audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees (2.12b); and
- to examine and report in the audit report on the reliability of information presented in the auditee's annual report about its directors' and senior executives' remuneration policy and record (2.17d).

In the UK in 1999, responsibility 2.12b qualified as a responsibility reasonably expected of auditors and featured an element of the deficient standards gap (see Figure 7.1). Responsibility 2.17d was an existing responsibility of auditors. The society group considered that auditors perform this responsibility satisfactorily and thus it did not feature as an element of the audit expectation-performance gap.

In 1989 in NZ, the responsibility 'to audit half-yearly financial statements' (2.22a) met the cost-benefit criterion to qualify as a responsibility reasonably expected of auditors but it was not an existing responsibility of auditors and, therefore, it contributed to the deficient standards gap. In 1999 in the UK, auditors' performance of this responsibility was adjudged not to be cost-effective and, thus, it constituted an element of the reasonableness gap (see Figures 7.1 and 7.2).

A further nine responsibilities, not included in the 1989 survey, were found to contribute to the reasonableness gap in the UK in 1999. These are the responsibilities:

- to detect minor (but not petty) theft of auditee assets by non-managerial employees, or by the directors or senior management (2.9a and 2.9b);
- to examine and report in the audit report on the auditee's computer systems (2.19), on the reliability of the information presented in its entire annual report (2.26a), and on the adequacy of procedures for identifying and managing its risk exposures (2.29);
- to audit quarterly published financial statements (2.22b);
- to examine and report in the audit report on the effectiveness of the auditee's internal non-financial controls (2.18b);
- to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report (in the audit report) instances of non-compliance (2.27aii); and
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet (2.30).

Comparing the responsibilities found to contribute to the reasonableness gap in 1989 and 1999, respectively, it may be seen that the additional responsibilities featuring as elements of the gap in 1999 derive primarily from a marked increase in society's expectations of auditors in the corporate governance arena. In the main, the additional responsibilities relate to matters that were not significant in the auditing environment in 1989 in either the UK or NZ.

One further responsibility contributing to the reasonableness gap in 1999 is of particular note. The suggested responsibility 'to prepare the auditee's financial statements' (2.1) did not qualify for inclusion in society's expectations of auditors in NZ in 1989 but did in the UK 1999[1]. This change was unexpected and it should be of concern to the auditing profession that 30% of the non-financial community group and (even more surprisingly) 41% of the financial community audit beneficiaries signified that auditors should perform this responsibility (see Table 6.1).

Summary and key issues

In this chapter the research findings relating to the composition of the audit expectation-performance gap reported in previous chapters have been summarised and presented diagrammatically. The means by which the extent of each component of the gap has been determined has also been explained and the relative contribution of each component to the overall expectation-performance gap discussed. Additionally, the composition and extent of the audit expectation-performance gap as it was found to exist by the current research in 1999 in the UK has been compared with that pertaining in NZ in 1989.

Key issues highlighted in this chapter include the following:

- The constitution of the audit expectation-performance gap in the UK in 1999 differed significantly from that found to exist by Porter (1993) in NZ in 1989. More specifically, each of the two portions comprising the performance gap (the deficient performance and deficient standards gaps) have narrowed markedly during the decade from 1989 to 1999 but the resulting reduction in the audit expectation-performance gap has been more than countered by a significant expansion of the reasonableness gap.
- The widening of the reasonableness gap is largely attributable to the increase in society's expectations of auditors in respect of corporate governance issues which were not of importance in the audit environment in 1989 in either the UK or NZ. However, it is also noted that all of the responsibilities constituting the reasonableness gap in NZ in 1989 reappeared in the UK in 1999. This suggests that education of members of society, in particular, financial statement users (through, for example, the long form audit report) about the audit function and what auditors can reasonably expect to achieve, has not had any noticeable impact on society's expectations of auditors.
- Two unreasonable expectations of auditors which qualified for inclusion in the set of responsibilities constituting 'society's expectations of auditors' in both 1989 and 1999,[2] and one which qualified only in 1999, should be of particular concern to the auditing profession as they reflect a fundamental lack of understanding within society of the audit function. These are as follows:
  - to guarantee that the audited financial statements are completely accurate (2.2). (In 1989 in NZ, and in 1999 in the UK, 39% and 37%, respectively, of the society group indicated that auditors should perform this responsibility);
  - to guarantee that an auditee whose financial statements are given an unqualified audit report is financially sound (2.4). (In 1989 in NZ, and in 1999 in the UK, 41% and 45%, respectively, of the society group indicated that auditors should perform this responsibility)
  - to prepare the auditee's financial statements (2.1). (In 1989 in NZ, and in 1999 in the UK, 12% and 26%, respectively, of the society group indicated that auditors should perform this responsibility).

Endnotes:

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1 In 1989 only 8% of the society group in NZ signified auditors should perform this responsibility. In 1999 in the UK, the proportion was 26%.

2 As explained in chapter six, for the purposes of the research, suggested responsibilities of auditors included in the survey instrument that were identified by 20% or more of the society group as responsibilities auditors should perform comprise 'society's expectations of auditors'.

Chapter Eight

Survey Findings in New Zealand – 1999

In chapter one it was noted that the research conducted in the UK in 1999 was part of a wider study designed to investigate, *inter alia*, the nature, composition and extent of the audit expectation-performance gap in both the UK and NZ in 1999. The results of the UK portion of the study have been reported in chapters three to seven. In this chapter the results of the survey conducted in NZ in 1999 are reported in summary form. The research methodology is first outlined and the survey results are then reported. In chapter nine, the extent of the audit expectation-performance gap overall, and the relative contribution of its constituents, are reported and presented diagrammatically.

Research methodology

As in the UK, the research was conducted in NZ between November 1999 and January 2000. The groups surveyed were the same as those surveyed in the UK in 1999 and in NZ in 1989. A total of 1534 questionnaires were mailed to named individuals. Details of the interest groups surveyed in NZ and their response rates are presented in Table 8.1[1]. As may be seen from Table 8.1, the overall usable response rate was 33%, ranging from 38% for the auditee group to 26% for the non-financial community audit beneficiaries.

As for the survey groups, the same survey instrument was used in both the UK and NZ, with minor modifications in the wording to reflect institutional differences. Additionally, 49 rather than 51 (as in the UK) suggested responsibilities of auditors were listed in the questionnaire. In NZ, the Stock Exchange has not introduced a requirement for the auditors of listed companies to examine (and report on) their auditees' compliance with either all or a specified sub-set of its corporate governance requirements. As a result, the NZ version of the questionnaire included just two (rather than four) suggested responsibilities relating to this issue. These were as follows:

In the case of a listed company, to examine its compliance with the Stock Exchange's corporate governance requirements and to report (in the audit report):

(a) Whether or not it has complied with those requirements (2.27a); and

(b) only instances of non-compliance (2.27b).

The two responsibilities included in the UK version of the questionnaire relating to compliance with a specified set of Stock Exchange's corporate governance requirements were omitted.

Existing responsibilities of auditors in NZ

As explained in chapter four, in the UK portion of the research, 13 of the 51 suggested responsibilities listed in the questionnaire were identified as existing responsibilities of auditors. In the NZ part of the research nine of the 49 suggested responsibilities were so identified (all 9 are existing responsibilities of auditors in the UK).

As noted above, in NZ, auditors do not have a responsibility to examine and report on their listed company auditees' compliance (or otherwise) with the Stock Exchange's corporate governance requirements (responsibilities 2.27a and b). Similarly, (unlike auditors in the UK) they are not required to examine and report on the reliability of information provided in auditees' annual reports about their directors' and senior executives' remuneration policy and record (2.17d), nor are they required, in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority (such as the Serious Fraud Office (SFO), police or Registrar of Companies) if during an audit it is discovered that the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts (responsibilities 2.11c and 2.16, respectively).

Table 8.1 Sample groups and response rates – NZ 1999

Interest group	No. in survey	No. of usable responses	% usable responses
Auditors			
Audit partners	78	28	36
Audit staff	122	42	34
Total	200	70	35
Auditees			
Internal auditors	100	63	63
Financial Directors	100	37	37
Chief Executives	100	24	24
Non-Executive Directors	100	28	28
Total	400	152	38
Audit beneficiaries: Financial community			
Stockbrokers	100	26	26
Financial analysts/Institutional Investors	59	26	44
Bankers – corporate lenders	100	38	38
Auditing/Accounting regulators	10	5	50
Auditing academics	15	11	73
Total	284	106	37
Audit beneficiaries: Non-financial community			
Solicitors	100	32	32
Financial Journalists	50	10	20
General public	500	129	26
Total	650	171	26
Combined totals	**1534**	**499**	**33**

The opinions of the survey groups in respect of auditors' existing responsibilities are presented in Table 8.2[2]. From Table 8.2 it may be seen that the interest groups overall failed to identify correctly just one of auditors' existing responsibilities, namely: 'to examine the auditee's entire annual report and to report (in the audit report) on information in the annual report that is inconsistent with the financial statements' (2.26b) and this result is not statistically significant. Of the individual interest groups, only the auditors and financial community audit beneficiaries failed to recognise this as an existing responsibility of auditors. The auditors also failed to recognise as one of their responsibilities: 'to detect illegal acts committed by the auditee's directors or management which directly impact on the company's financial statements (such as bribery and political payoffs)' (2.14a). The auditees and non-financial community audit beneficiaries correctly identified all of auditors' existing responsibilities.

Table 8.2 Means of interest group responses in relation to existing responsibilities

Resp. No.	Interest Group	Interest Groups Overall	Auditors	Auditees	Audit Beneficiaries Financial Community	Audit Beneficiaries Non-Fin Community
	No of respondents in group	*499*	*70*	*152*	*106*	*171*
	Suggested responsibilities of auditors[1]	mean[4]	*mean*[3]	*mean*[3]	*mean*[3]	*mean*[3]
	Actual existing responsibilities[2]					
2.3	State whether auditee's financial statements fairly reflect its financial affairs	91	100	94	92	76
2.10	Detect deliberate distortion of auditee's financial statements	74	46	87	79	83
2.5b	Disclose in the audit report doubts about auditee's continued existence	63	74	71	61	47
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	56	47	72	53	50
2.6	Ensure compliance with relevant legislation	51	50	50	58	47
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	26	11	5*	33	53
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	23	-9*	21	31	47
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	22	11	1*	26	48
2.26b	Examine & report (in audit report) on information in auditee's annual report which is inconsistent with financial statements	-2*	-16	5*	-11	15
	Not existing responsibilities of auditors					
2.18a	Examine and report (in audit report) on the effectiveness of auditee's internal financial controls	31	-17	47	38	56
2.28	Examine and report to auditee's directors (or equivalent) on adequacy of auditee's risk management procedures	12	16	19	9*	4*
2.12c	Disclose in the audit report embezzlement of auditee's assets by directors/senior management	9	-29	14	6*	45
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on auditee's financial statements	6*	-40	11	8*	45
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), embezzlement of auditee's assets by directors/senior management	-4*	-39	-14	9*	29
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), deliberate distortion of auditee's financial statements	-7*	-52	-19	12	30
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	-16	-62	-23	-12	33
2.22a	To audit half-yearly published financial statements	-23	-41	-41	-15	4*
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	-27	-55	-32	-16	-5*
2.16	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) illegal acts by auditee officials	-28	-56	-41	-21	7*
2.27a	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	-28	-60	-37	-28	13
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	-28	-69	-55	3*	8*
2.5a	Report to an appropriate authority (*eg* Registrar of Cos or Reserve Bank) doubts about auditee's continued existence	-29	-41	-56	-26	6*

2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its directors/senior executives' remuneration policy and record	-31	-66	-30	-23	-6*
2.13	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) suspicions of theft or deliberate distortion of auditee's financial statements	-37	-77	-60	-22	12
2.27b	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	-38	-51	-36	-50	-14
2.18b	Examine and report (in the audit report) on the effectiveness of auditee's internal non-financial controls	-39	-70	-32	-28	-25
2.11b	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), theft of material amount of auditee's assets by non-managerial employees	-42	-78	-64	-16	-11
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-43	-76	-53	-28	-13
2.2	Guarantee auditee's financial statements are accurate	-47	-89	-80	-33	14
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	-47	-97	-70	-28	9*
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	-48	-86	-57	-43	-6*
2.22b	To audit quarterly published financial statements	-49	-59	-70	-51	-16
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	-50	-91	-66	-39	-2*
2.30	Examine and report (in attached audit report) on reliability of auditee's financial information on the internet	-50	-66	-66	-53	-15
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	-52	-97	-76	-42	8*
2.29	Examine and report (in the audit report) on the adequacy of the auditee's risk management procedures	-56	-88	-67	-46	-21
2.7	Report breaches of tax law to Inland Revenue	-56	-84	-88	-46	-4*
2.19	Examine and report (in the audit report) on auditee's IT systems	-56	-75	-56	-54	-40
2.12a	Disclose in the audit report minor (but not petty) theft of auditee's assets by non-managerial employees	-57	-100	-81	-52	4*
2.11a	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), minor (but not petty) theft of auditee's assets by non-managerial employees	-61	-93	-85	-55	-12
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	-63	-94	-70	-52	-34
2.17c	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its occupational health and safety policy and record	-72	-94	-75	-70	-50
2.17b	Examine and report (in audit report) on reliability of information in auditee's annual report about its product safety policy and record	-72	-93	-78	-70	-48
2.25	Verify every transaction of the auditee	-74	-94	-93	-78	-30
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	-75	-94	-79	-76	-49
2.20	Examine and report (in the audit report) on auditee's non-financial performance	-67	-80	-68	-66	-54
2.1	Prepare auditee's financial statements	-80	-94	-99	-76	-52
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	-82	-93	-93	-84	-59

2.24a	Consider and report (in the audit report) on the impact of auditee on its local community	–83	–93	–95	–84	–59

1 The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.

2 Identified by reference to Statute law, Case law and professional promulgations.

3 Means of responses of the relevant interest group expressed as whole numbers (*ie.* mean calculated as a decimal multiplied by 100).

4 The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).

* Not significant at the 0.05 level (*ie.* no valid generalised conclusion can be drawn about the opinion of the interest group regarding the particular responsibility)

Nevertheless, reviewing the means of the interest groups' responses presented in Table 8.2, the most striking feature is the incorrect recognition by the interest groups of suggested responsibilities of auditors listed in the questionnaire as existing responsibilities and the increase in the number of such incorrectly identified responsibilities the further the individual interest group is from the audit function. The interest groups overall incorrectly identified four of the suggested responsibilities as existing responsibilities of auditors. These are as follows:

- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a);
- to examine and report privately to the directors on the adequacy of procedures for identifying and managing the auditee's risk exposures (2.28);
- to disclose the fact in the audit report if during the audit it is discovered that the auditee's directors or senior management have embezzled organisational assets, or committed other illegal acts which directly impact on the company's financial statements (such as bribery or political payoff) (2.12c and 2.15a, respectively: in the latter case the survey result is not statistically significant).

While the auditors incorrectly recognised as one of their existing responsibilities, responsibility 2.28 (see above), the auditees wrongly identified as existing responsibilities the same four suggested responsibilities as the interest groups overall. The financial community audit beneficiaries also incorrectly identified these four suggested responsibilities together with a further three, namely:

- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the police or Registrar of Companies), if during an audit it is discovered that the auditee's directors or senior management have embezzled organisational assets, or that the information presented in the auditee's financial statements has been deliberately distorted (2.11c, 2.11d);
- to examine and to report (in the audit report) on the reliability of the information presented in the auditee's entire annual report (2.26a).

Perhaps not surprisingly, given their distance from the audit function, the non-financial community group incorrectly identified as existing responsibilities of auditors a wide range of the suggested responsibilities listed in the questionnaire (17 such responsibilities were incorrectly identified, nine of which were at a statistically significant level: see Table 8.2).

Estimate of the interest groups' 'knowledge gap'

As for auditors' interest groups in the UK, the 'knowledge gap' of auditors' interest groups in NZ was calculated (see Chapter 4 for an explanation of how the calculation was performed). The relevant information is presented in Appendix D[3]. From Appendix D it may be seen that, as might be expected, auditors are relatively knowledgeable about their existing responsibilities although some 20% are incorrect or uncertain about them[4]. The auditees (who are closer to the work of auditors than the other two groups) are the next most knowledgeable, followed by the financial community audit beneficiaries. (On average, auditees are 27% in error or uncertain about auditors' existing responsibilities compared with 39% of financial community audit beneficiaries). As might be anticipated, the knowledge of the non-financial community group is the least good of the interest groups. The survey results suggest that about 59% of this group has very limited knowledge about auditors' existing responsibilities.

Perceived performance of auditors' responsibilities

As explained in chapter three, for the purposes of the research, two criteria were adopted to differentiate satisfactory from unsatisfactory performance of auditors' responsibilities. These are: a mean of responses from an interest group of less than 2.0, and 20% or more of an interest group signifying that auditors perform the relevant responsibility poorly.

As may be seen from Table 8.3, applying these criteria, the interest groups overall considered that auditors perform six of the nine existing responsibilities of auditors included in the questionnaire satisfactorily; the performance of the other three was adjudged to be sub-standard. However, the views of the individual interest groups varied quite significantly. The auditor group was alone in judging the performance of all of their existing responsibilities to be satisfactory. The financial community group was the least satisfied, signifying that auditors perform five of their responsibilities deficiently. These are the responsibilities:

- to disclose the fact in the audit report if during an audit it is discovered that information in the financial statements has been deliberately distorted, or if the auditor has doubts about the continued existence of the auditee (2.12d, 2.5b);
- to detect illegal acts by the auditee's directors or management which directly impact on the financial statements (such as bribery and political payoffs) (2.14a);
- to detect theft of a significant amount of auditee assets by non-managerial employees, or by the directors or senior management (2.8a, 2.8b).

The auditee group shared the opinion of the financial community audit beneficiaries about auditors' performance of responsibilities 2.14a, 2.8a and 2.8b (see above); the non-financial community group similarly shared their opinion with respect to four of the five of the responsibilities noted above; the exception was 2.8a – a responsibility they considered auditors perform satisfactorily.

Deficient performance component of the audit expectation-performance gap

Composition of the deficient performance gap

As explained in chapter five, the deficient performance component of the audit expectation–performance gap may be determined by reference to the responsibilities the society group (*ie.* all non-auditors) considers that auditors perform deficiently. The society group's assessment of auditors' performance of their existing duties is presented in Table 8.4. From this Table, applying the criteria outlined above, it may be seen that five responsibilities are identified as comprising the deficient performance component of the audit expectation-performance gap in NZ. Three of these involve auditors detecting the theft of a significant amount of auditee assets by non-managerial employees or by the directors or senior management (2.8a and 2.8b), and detecting other illegal acts committed by the directors or senior management which directly impact on the financial statements (2.14a). The other two relate to auditors making relevant disclosures in the audit report if during the audit it is discovered that the financial statements have been deliberately distorted (2.12d), or if they have doubts about the continued existence of the auditee (2.5b).

It is pertinent to note (from Table 8.3) that auditors' assessment of their performance of responsibilities 2.5b and 2.12d (see above) is 'good' (in each case, the mean of their responses is 2.3, and just 5% and 8%, respectively, of auditors indicated that performance of these duties is poor). Similarly, auditors adjudge their performance of responsibilities 2.8a, 2.8b and 2.14a to be 'satisfactory' (the mean of their responses to these responsibilities is 2.0 or 2.1, and only 10% or 11% of auditors signalled that they are performed poorly: see Table 8.3).

However, notwithstanding the views of the auditor group about auditors' performance of their responsibilities, it should be of concern to the auditing profession in NZ that a significant proportion of the society group (representing society at large) signified that, of the nine existing responsibilities of auditors included in the questionnaire, auditors' performance of five of them is sub-standard.

Table 8.3 Assessment of auditors' performance based on the means of interest group responses and proportion of the interest groups signifying the responsibilities are poorly performed

Resp No.	**Interest Group**	**Interest Groups Overall**		**Auditors**		**Auditees**		**Audit Beneficiaries – Financial Community**		**Audit Beneficiaries – Non-Fin Community**	
	No of respondents in group	*499*		*70*		*152*		*106*		*171*	
	Suggested responsibilities of auditors[1]	*mean*[4]	*Poor Perf. Av.%*[5]	mean	*Poor Perf. %*[3]	*mean*	*Poor Perf. %*[3]	*mean*	*Poor Perf. %*[3]	*mean*	*Poor Perf. %*[3]
	Performance - Good or Satisfactory[2]										
2.3	State whether auditee's financial statements fairly reflect its financial affairs	2.5	4	2.8	0	2.5	6	2.3	4	2.4	5
2.6	Ensure compliance with relevant legislation	2.3	7	2.3	14	2.4	5	2.3	5	2.3	4
2.26b	Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with the financial statements*	2.2	6	2.3	11	2.3	3	2.2	5	2.2	3
2.10	Detect deliberate distortion of auditee's financial statements	2.2	8	2.4	2	2.2	11	2.0	12	2.2	7
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	2.0	15	2.3	8	2.0	17	***1.7***	***23***	***1.9***	13
2.5b	Disclose in the audit report doubts about auditee's continued existence	2.0	16	2.3	5	2.0	***24***	***1.8***	***22***	2.0	14
	Performance - Unsatisfactory[2]										
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)*	***1.9***	15	2.0	10	***1.8***	***27***	***1.9***	13	***1.9***	11
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	***1.9***	19	2.0	11	***1.7***	***33***	***1.8***	15	***1.9***	15
2.8a	Detect theft of material amount (*eg* >5% of turnover or total assets) of auditee's assets by non-managerial employees	***1.9***	19	2.1	11	***1.8***	***32***	***1.5***	11	2.0	12

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.

[2] An average mean of 1.9 (calculated from responses to options other than 'unable to judge') and an average of 20% of the interest groups signifying that auditors perform the responsibility poorly have been adopted as points of differentiation between satisfactory and unsatisfactory performance by auditors.

[3] Proportion of the interest group signifying that auditors perform the responsibility poorly.

[4] The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).

[5] Average of the proportions of the four identified interest groups signifying that auditors perform the responsibility poorly.

* Not recognised by auditors as an existing responsibility (See Table 8.1).

Relative contribution of responsibilities to the deficient performance gap

In addition to enabling the responsibilities that constitute the deficient performance component of the audit expectation-performance gap to be identified, the responses of the society group, indicating their assessment of auditors' performance of their responsibilities, enable the relative contribution of each responsibility to the deficient performance gap to be determined. This may be accomplished by reference to the proportion of the society group who signified that auditors perform a responsibility poorly and whose expectations with respect to the duty are, therefore, not being fulfilled. The greater the level of unfulfilled expectations attaching to a responsibility, the greater the contribution of the responsibility to the deficient performance gap. (The respective contributions of the five responsibilities constituting the deficient performance gap are shown in Table 8.4.)

From Table 8.4 it may be seen that auditors' poor performance of their responsibility 'to detect the theft of a significant amount of auditee assets by the directors or senior managers' (2.8b) accounts for 23% of the deficient performance gap, and a further 21% and 20%, respectively, is accounted for by auditors' poor performance of their responsibilities 'to disclose in the audit report doubts about the continued existence of the auditee' (2.5b), and 'to detect the theft of a significant amount of auditee assets by non-managerial employees' (2.8a).

Table 8.4 Society group's[1] assessment of auditors' performance of their existing responsibilities

Resp No.	Suggested responsibilities of auditors[2]	Means of responses	Poorly	OK[4]	Well	Unable to judge	Contrib. to deficient perform. gap[5]
	Deficient performance gap responsibilities[3]	*mean*	%	%	%	%	%
2.8b	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by its directors/senior management	***1.9***	***21***	24	10	45	23
2.5b	Disclose in the audit report doubts about the auditee's continued existence	***1.9***	***20***	37	15	28	21
2.8a	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by non-managerial employees	***1.8***	19	25	11	45	20
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	***1.9***	17	33	12	38	18
2.14a	Detect illegal acts by auditee officials which directly impact on the auditee's financial statements (*eg* political payoffs)⋆	***1.9***	17	25	9	49	18
	Non-deficient performance gap responsibilities						**100**
2.10	Detect deliberate distortion of the auditee's financial statements	2.1	10	39	20	31	-
2.26b	Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements⋆	2.2	4	38	18	40	-
2.6	Ensure compliance with relevant legislation	2.3	5	39	29	27	-
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	2.4	5	37	38	20	-

1 All non-auditor interest groups (auditees, financial community and non-financial community audit beneficiaries)
2 The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire
3 An average mean of 1.9 (calculated from responses to options other than 'unable to judge') and an average of 20% of the 'society' interest groups signifying that auditors perform the responsibility poorly have been adopted as points of differentiation between satisfactory and unsatisfactory performance by auditors. (Using the average of the 'society' interest groups' responses eliminates the effect of difference sample sizes).
4 Represents the response option 'adequately'.
5 Based on the average proportion of the society interest groups group who signified that auditors perform the responsibility poorly.
⋆ Not recognised by auditors as an existing responsibility (see Table 8.1).

Responsibilities auditors should perform

As for the UK survey, for each suggested responsibility of auditors listed in the questionnaire, respondents in NZ were asked to indicate whether the responsibility should, or should not, be performed by auditors, or whether they were not sure. The results for this portion of the research are presented in Table 8.5.

Opinions of the interest groups overall

From Table 8.5 it may be seen that the interest groups overall indicated that 23 of the 49 suggested responsibilities of auditors listed in the questionnaire should be performed by auditors (the means of their responses to these responsibilities are positive). These include the nine existing responsibilities of auditors and also the following:

- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls, and on the reliability of financial forecasts included in its annual report (2.18a and 2.23);
- to disclose the fact in the audit report if during the audit it is discovered that the theft of a significant amount of auditee assets has been committed by non-managerial employees or by the directors or senior management, or that the directors or senior management have committed other illegal acts which directly impact on the auditee's financial statements (such as bribery and political payoffs) (2.12b, 2.12c, 2.15a);
- to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing the organisation's risk exposures (2.28);
- in absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the SFO, police or Registrar of Companies) if during the audit it is discovered that:
  - the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts (2.11c, 2.16);
  - the information in the financial statements has been deliberately distorted (2.11d); or
  - suspicious circumstances are encountered which suggest that theft or deliberate distortion of the financial information may have occurred (2.13);
- for listed company auditees, to examine their compliance with the Stock Exchange's corporate governance requirements and to report (in the audit report) on their compliance therewith, or on instances of non-compliance (2.27a, 2.27b);
- to audit half-yearly published financial statements (2.22a);
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet (2.30).

Table 8.5 Responsibilities the interest groups consider auditors should perform

Resp. No.	Interest Group	Interest Groups Overall	Auditors		Auditees		Audit Beneficiaries Financial Community		Audit Beneficiaries Non-Fin Community		Society Group[6]
	No of respondents in group	*499*	*70*		*152*		*106*		*171*		*429*
	Suggested responsibilities of auditors[1]	mean[3]	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*mean[4]*	*%[5]*	*%[5]*
	Duties auditors should perform[2]										
2.3	State whether auditee's financial statements fairly reflect its financial affairs	93	100	100	91	95	94	96	85	89	93
2.10	Detect deliberate distortion of auditee's financial statements	79	42	69	93	96	93	96	88	90	94
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	75	53	75	89	94	78	84	80	82	65
2.5b	Disclose in the audit report doubts about auditee's continued existence.	74	74	86	86	92	77	85	60	70	82
2.18a	Examine and report (in the audit report) on the effectiveness of auditee's internal financial controls	61	23	61	67	84	78	88	74	79	63
2.6	Ensure compliance with relevant legislation	56	36	67	64	82	67	81	58	69	77
2.12c	Disclose in the audit report embezzlement of auditee's assets by directors/senior management	47	-6*	45	67	81	51	69	77	80	77
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on auditee's financial statements	40	-14	39	60	78	43	66	72	78	74
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	48	-7*	43	55	75	66	80	76	82	79
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	48	9*	52	38	66	66	80	80	85	77
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	45	9*	51	34	64	63	77	75	81	74
2.28	Examine and report privately to auditee's directors on the adequacy of its risk management procedures	41	41	68	51	73	45	67	26	48	63
2.11c	In absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos), embezzlement of auditee assets by directors/ senior management	34	-17	41	32	63	60	75	61	72	70
2.26b	Examine and report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements	30	12	54	45	72	30	57	33	55	61
2.11d	In absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos), deliberate distortion of auditee's financial statements	24	-35	32	25	61	51	70	55	68	66
2.16	In absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos) illegal acts committed by auditee's officials	17	-23	34	13	54	30	59	47	62	58
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	17	-18	39	25	60	27	58	32	52	57
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	16	-39	30	16	57	29	58	57	69	61
2.22a	To audit half-yearly published financial statements	14	16	57	-4*	44	16	52	28	48	48
2.30	Examine and report (in attached audit report) on the reliability of auditee's financial information on the internet	10	16	55	-2*	44	-3*	39	29	16	33
2.27a	For listed company auditees, to examine compliance with Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	8*	-22	37	22	55	-2*	40	35	50	48
2.27b	For listed company auditees, to examine compliance with Stock Exchange's governance requirements and report (in the audit report) on instances of non-compliance	6*	-19	38	8*	49	-9*	5	-4*	26	N/A[7]
2.13	In absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos) suspicions of theft or deliberate distortion of auditee's financial statements	5*	-39	30	-21	35	22	53	56	69	52

	***Duties auditors should not perform*[2]**										
2.5a	Report to appropriate authority (*eg* Registrar of Cos or Reserve Bank) doubts re auditee's continued existence.	-1★	-16	40	-19	38	4★	43	26	51	44
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	-3★	-40	28	-10	42	17	53	20	49	48
2.11b	In absence of regulated industry duty, report to appropriate authority (*eg* Police or Registrar of Cos), theft of material amount of auditee's assets by non-managerial employees	-5★	-56	21	-26	35	23	57	39	60	51
2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about directors/senior executives' remuneration policy and record	-10	-59	19	-5★	44	18	55	7★	43	47
2.18b	Examine & report (in the audit report) on effectiveness of auditee's internal non-financial controls	-16	-55	21	-5★	45	3★	49	-5★	34	43
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-18	-66	15	-26	34	5★	46	16	47	42
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	-21	-65	15	-25	35	-6★	37	13	44	39
2.29	Examine and report (in the audit report) on the adequacy of auditee's risk management procedures	-23	-79	9	-15	39	-10	37	12	39	38
2.4	Guarantee auditee (with clean audit report) is financially sound	-24	-75	12	-30	32	-10★	43	20	51	42
2.22b	To audit quarterly published financial statements	-26	-24	35	-50	22	-27	32	-2★	34	29
2.19	Examine & report (in audit report) on auditee's IT systems	-32	-49	22	-15	38	-33	25	-31	21	28
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	-32	-93	3	-59	17	-2★	43	26	55	38
2.2	Guarantee auditee's financial statements are accurate	-36	-88	6	-75	11	-10★	43	30	59	38
2.7	Report breaches of tax law to Inland Revenue Department	-38	-71	12	-71	11	-20	31	12	47	27
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	-38	-93	3	-66	14	-17	36	24	53	34
2.12a	Disclose in the audit report minor (but not petty) theft of auditee's assets by non-managerial employees	-42	-98	0	-65	16	-32	27	27	54	32
2.21	Examine & report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	-44	-81	8	-47	23	-22	32	-25	25	27
2.11a	In absence of regulated industry duty, report to appropriate authority (*eg* Police or Registrar of Cos), minor theft of auditee assets by non-managerial employees	-46	-88	6	-73	12	-27	32	5★	42	29
2.20	Examine and report (in the audit report) on auditee's non-financial performance	-49	-53	22	-43	23	-52	13	-49	14	17
2.17c	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its occupational health and safety policy and record	-55	-85	3	-49	24	-43	22	-42	15	20
2.17b	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its product safety policy and record	-57	-85	3	-56	19	-45	21	-40	17	19
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	-58	-82	6	-59	18	-51	20	-40	17	18
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	-66	-77	10	-67	13	-68	11	-50	12	12
2.24a	Consider and report (in audit report) on the impact of auditee on its local community	-70	-81	9	-75	9	-73	9	-50	12	10
2.25	Verify every transaction of the auditee	-73	-91	4	-95	2	-73	9	-31	24	12
2.1	Prepare auditee's financial statements	-78	-88	6	-99	1	-78	9	-45	21	10

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
[2] Responsibilities identified as those auditors should/should not perform based on the means of interest groups' responses.
[3] The average of the means of the four identified interest groups (eliminating the effect of different sample sizes).
[4] Means of responses of the relevant interest group expressed as whole numbers (ie. mean calculated as a decimal multiplied by 100).
[5] Proportion of interest group signifying that auditors should perform the responsibility.
[6] Average of the proportion of non-auditor interest groups signifying auditors should perform the responsibility. (Averaging eliminates different sample sizes.)
[7] 2.27b subsumed by 2.27a as explained in the text.
★ Not significant at the 0.05 level (i.e. no valid generalised conclusion can be drawn about the opinion of the interest group regarding the particular responsibility).

It should be noted from Table 8.5 that, for 15 of the 23 suggested responsibilities identified by the interest groups overall as responsibilities auditors should perform, the mean of their responses is +24 or more, reflecting a relatively high level of agreement among the respondents regarding auditors' performance of these responsibilities. However, in the case of responsibilities 2.27a, 2.27b and 2.13 (see above), the survey results are not statistically significant.

Reviewing the 14 responsibilities (listed above) the interest groups overall indicated auditors should perform in addition to their existing responsibilities, it may be seen that 12 involve additional reporting by auditors. Eight of these responsibilities[5] would appear to require auditors to report information they have (or should have!) within their knowledge as a result of their audit work. Thus, *prima facie,* performing these additional reporting responsibilities would involve little additional audit cost but would reap benefits in terms of closer alignment of auditors' responsibilities and society's expectations of auditors.

Opinions of the individual interest groups

As might be expected, of the individual interest groups, the auditors identified the smallest number (12 in total) of suggested responsibilities as those they should perform. This included eight of their existing responsibilities – the exception being 'to detect illegal acts committed by the auditee's directors or senior management which directly impact on the financial statements' (2.14a). The other four (not existing) duties they considered they should perform are:

- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a);
- to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing its risk exposures (2.28);
- to audit half-yearly published financial statements (2.22a);
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet (2.30).

The auditee group considered that auditors should perform 20 of the 23 responsibilities the interest groups overall identified as responsibilities auditors should perform. Interestingly, two of those not so identified by the auditees – namely, 'to audit half-yearly published financial statements' (2.22a), and 'to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet' (2.30) – are two responsibilities the auditors considered they should perform (see above). It may be that the auditee group believes the performance of these duties by auditors would involve additional audit time and higher audit fees and that the added cost would not result in commensurate benefits. The other exclusion from the 23 responsibilities the interest groups overall indicated auditors should perform is the responsibility: 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the police or the Registrar of Companies) if during the audit suspicious circumstances are encountered suggesting that theft or deliberate distortion of the financial statements may have occurred' (2.13). The auditor group agreed with the auditees that they should not be required to perform this responsibility but both of the audit beneficiary groups held the contrary view.

The financial community audit beneficiaries signified that auditors should perform 26 of the 49 suggested responsibilities listed in the questionnaire. This includes 20 of the 23 responsibilities identified by the interest groups overall as responsibilities auditors should perform (the three exceptions, none of which were at a statistically significant level, are responsibilities 2.27a, 2.27b and 2.30: see above and Table 8.5). The other six responsibilities the financial community group (but not the interest groups overall) considered auditors should perform are:

- to examine the auditee's entire annual report and to report (in the audit report) on the reliability of the information contained in the report as a whole and, in particular, on information about the directors' and senior executives remuneration policy and record (2.26a, 2.17d);
- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the SFO, police or Registrar of Companies) if during the audit it is discovered that theft of a significant amount has been committed by non-managerial employees (2.11b);
- to examine and report (in the audit report) on the effectiveness of the auditee's non-financial internal controls (2.18b);
- where the auditor has doubts about the continued existence of the auditee, to express those doubts privately to an appropriate authority such as the Registrar of Companies or the Reserve Bank (2.5a);
- to detect illegal acts by the auditee's directors or senior management which only indirectly impact on the financial statements (2.14b).

It should be noted that the survey results in respect of responsibilities 2.18b, 2.5a, and 2.14b (see above) are not statistically significant.

The non-financial community audit beneficiaries indicated that auditors should perform a very wide range of responsibilities. These included 22 of the 23 responsibilities so identified by the interest groups overall (the exception being responsibility 2.27b: see Table 8.5), five of the six additional responsibilities considered by the financial community group to be responsibilities auditors should perform (the exception is responsibility 2.18b: see Table 8.5), and a further nine responsibilities not identified by any of the other interest groups as responsibilities auditors should perform. (Thus, the non-financial community group signified that auditors should perform 36 of the 49 suggested responsibilities included in the questionnaire.) Two responsibilities identified by the non-financial community audit beneficiaries as responsibilities auditors should perform are particularly notable. These are: 'to guarantee that the audited financial statements are completely accurate' (2.2), and 'to guarantee that an auditee whose financial statements are given an unqualified audit report is financially sound' (2.4). As noted in chapter seven, these two responsibilities were significant contributors to the reasonableness gap component of the audit expectation-performance gap both in the UK in 1999 and NZ in 1989.

Responsibilities reasonably expected of auditors

As explained in chapter six, for the purposes of the research a cost-benefit criterion, derived from the responses of the auditees and financial community audit beneficiaries signifying whether each responsibility listed in the questionnaire should or should not be a responsibility of auditors, was used to determine the responsibilities that are reasonable to expect of auditors.

Applying this criterion, it was found that 23 of the responsibilities listed in the questionnaire qualify as responsibilities reasonably expected of auditors. These include 21 of the 23 responsibilities the interest groups overall indicated auditors should perform (see Table 8.5): the two exceptions are: 'to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report (in the audit report) instances of non-compliance' (2.27b), and 'to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet' (2.30). The other two responsibilities qualifying as reasonably expected of auditors are: 'to examine an auditee's entire annual report and to report (in the audit report) on the reliability of information contained in the report as a whole' and, in particular, 'about its directors' and senior executives' remuneration policy and record' (2.26a and 2.17d).

Society's expectations of auditors

It was noted in chapter six that, within the context of the research, if 20% or more of the society group (*ie.* all non-auditor respondents) indicate that a responsibility should be performed by auditors, then it warrants further examination to ascertain whether it is (or is not) a responsibility which is reasonable to expect of auditors.

Thus, all of the suggested responsibilities listed in the questionnaire identified by 20% or more of the society group as responsibilities auditors should perform are deemed to constitute 'society's expectations of auditors' (the right boundary of the audit expectation-performance gap depicted in Chapter 2, Figure 2.1).

Analysing the society group's responses, it was found that all of the respondents who indicated that the responsibility: 'to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report (in the audit report) *instances of non-compliance'* (2.27b) should be a responsibility of auditors, similarly signified that the more stringent responsibility ['to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report *whether or not it has complied* with those requirements' (2.27a)] should be a responsibility of auditors. Given that the latter subsumes the former, for the purposes of ascertaining the constitution of the audit expectation-performance gap, responsibility 2.27b is treated as a subset of 2.27a. This leaves 48 rather than 49 suggested responsibilities of auditors to be investigated further.

Reasonableness gap component of the audit expectation-performance gap

From the column headed 'Society Group' in Table 8.5, it may be seen that 41 of the 48 suggested responsibilities of auditors qualify for further examination. Just seven were identified by less than 20% of the society group as responsibilities auditors should perform. These are the responsibilities:

- to examine and report (in the audit report) on:
  - the auditee's impact on its local community and environment (2.24a and 2.24b);
  - the auditee's non-financial performance (2.20);
  - the reliability of information contained in the auditee's annual report about its equal employment opportunities, and product safety, policy and record (2.17a and 2.17b);
- to examine evidence to verify every transaction entered into by the auditee (2.25);
- to prepare the auditee's financial statements (2.1).

Of the 41 responsibilities qualifying for examination to ascertain whether they are – or are not – responsibilities that are reasonable to expect of auditors, as noted above, 23 fall into the latter category. The remaining 18 do not meet the cost-benefit criterion and are, therefore, unreasonably expected of auditors. These 18 responsibilities constitute the 'reasonableness gap' component of the audit expectation-performance gap in NZ. As for the responsibilities comprising the reasonableness gap in the UK, these 18 responsibilities fall into two groups: those whose failure to meet the cost-benefit test is not difficult to explain and those which might have been expected to qualify as 'responsibilities reasonably expected of auditors'.

Responsibilities unreasonably expected of auditors – readily explainable

The responsibilities whose failure to meet the cost-benefit criterion is readily explainable include the suggested duties: 'to guarantee the auditee's financial statements are completely accurate' and 'an auditee whose financial statements receive an unqualified audit report is financially sound' (2.2 and 2.4). As observed in chapter six, it is not economically feasible for auditors to perform an audit so as to be in a position to *guarantee* that an auditee's financial statements are completely accurate and/or that the auditee is financially sound. To do so would require auditors to examine every transaction of the auditee – an activity that would result in prohibitive audit costs and, even then, it is unlikely that the auditors could be certain that nothing has been overlooked, and no errors have occurred, so as to be able to *guarantee* the complete accuracy of the auditee's financial statements and/or its financial soundness. It should be of concern to the auditing profession in NZ that such expectations of auditors were held by 42% of the society group in respect of responsibility 2.4, and by 38% for responsibility 2.2.

Three other responsibilities whose failure to meet the cost-benefit test may be readily explained relate to detecting and reporting (to an appropriate authority and/or in the audit report) *minor* theft of auditee assets by non-managerial employees (responsibilities 2.9a, 2.11a, and 2.12a). Auditors have an existing responsibility to detect *material* theft of assets by non-managerial employees which is not detected by the auditee's internal control systems but, providing they report such theft to the auditee's management, their existing responsibility is, in general, then satisfied (Porter, 1997). If auditors were required to detect and report (to an appropriate authority and/or in the audit report) minor theft of corporate assets by non-managerial employees, this would involve additional audit work and may also result in strained auditor-client relations. It seems likely that, if auditors were to perform the additional responsibilities, the added costs would outweigh the benefits that might result.

'To detect minor theft of organisational assets, or other illegal acts which only indirectly impact on the financial statements (such as breaches of occupational safety and environmental laws and regulations), committed by the auditee's directors or senior management' (responsibilities 2.9b and 2.14b), are two further responsibilities that do not meet the cost-benefit criterion. As noted in chapter six, some commentators contend that, even if they involve only small amounts, such acts by senior company officials 'go to the very integrity of management [and] the public has the right to know of this behaviour' (Davidson, 1975, pp.48-49). However, auditees and financial community audit beneficiaries[6] – interest groups that may be assumed to be sufficiently familiar with the audit function to be broadly aware of the attendant costs and benefits – do not appear to share this view. These groups may believe that, if auditors were required to detect minor theft of organisational assets by the directors or senior management and/or other illegal acts by these senior company officials that only indirectly impact on the financial statements (responsibilities which may be perceived to be somewhat distant from the focus of audit work), the additional audit time and cost involved would not be matched by commensurate benefits.

The failure of two other responsibilities to qualify as responsibilities reasonably expected of auditors can be readily explained by alternative – more demanding – responsibilities qualifying as cost-effective. While the responsibilities: 'to report *privately to an appropriate authority* (such as the Registrar of Companies) doubts about the continued existence of the auditee, or the theft of a significant amount of auditee assets by non-managerial employees discovered during the audit' (2.5a and 2.11b) do not qualify as responsibilities that are reasonable to expect of auditors, those of disclosing these matters *in the published audit report* (responsibilities 2.5b and 2.12b) do. Thus, the survey results suggest that it is reasonable for auditors to be required to report doubts about the continued existence of the auditee, and material theft of corporate assets by non-managerial employees discovered during the audit, in the audit report (a publicly available document). However, it is unreasonable to require them also to report such doubts and theft privately to an appropriate authority. The additional reporting requirements would appear to provide little in the way of additional benefits.

The responsibility 'to audit *half-yearly* published financial statements' (2.22a) qualifies as a responsibility reasonably expected of auditors but the responsibility 'to audit *quarterly* published financial statements' (2.22b) does not. It may be that, although the audit costs involved can be estimated from the audit fees disclosed in the annual financial statements (and may be perceived to be high), the benefits to be derived from the audit of quarterly financial statements are more difficult to gauge – and may be seen as fairly limited. Given that companies' annual financial statements are fully audited, it seems unlikely that auditees will stray too far from a 'true and fair view' in their interim financial statements. If they do so, their deviation is likely to be detected and interested parties will demand an explanation. Hence, it seems likely that the costs involved in auditing quarterly financial statements would not generate commensurate benefits – and this is particularly the case if, in accordance with society's expectations, half-yearly published financial statements become subject to audit.

Unreasonably expected responsibilities of auditors – less readily explainable

An unexpected finding of the research is the failure of the responsibility 'to disclose in the audit report illegal acts by the auditee's directors or senior management discovered during an audit that only indirectly impact on the auditee's financial statements (such as breaches of occupational safety and environmental laws and regulations)' (2.15b) to qualify as a responsibility reasonably expected of auditors. If auditors detect such illegal acts by the auditee's executives, it might be expected that it would be adjudged reasonable for them to disclose the information in the audit report – even if the acts concerned do not directly affect the financial statements. As noted above, such acts reflect on the integrity of the auditee's senior officials and, intuitively, it might be thought that the benefits of disclosing such information to external parties interested in the auditee would outweigh the (apparently) minimal additional audit costs involved in such reporting. It may be that the 'society group' (representing NZ society) considers that the potential legal and reputational costs for the auditors (arising, for example, from possible claims by the officials for defamation of character) and/or the cost of adverse consequences within (and for) the auditee that may result from such disclosure, are likely to outweigh the potential social benefits to be gained.

Given the apparent interest in – and demand for[7] – greater corporate social responsibility (including concern for the welfare of employees), and the increasing use of the internet to disclose organisations' financial (and non-financial) information, it might be expected that assurance about the reliability (or audit) of such information would meet the cost-benefit criterion. However, neither the responsibility 'to examine and report (in the audit report) on the reliability of information in the auditee's annual report about its occupational health and safety policy and record (2.17c) nor 'to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet' (2.30) qualify as responsibilities that are reasonable to expect of auditors.

Similar remarks apply to the responsibilities: 'to examine and report (in the audit report) on the auditee's computer systems, the effectiveness of its internal non-financial controls, the efficiency and effectiveness of its management and administration, and the adequacy of its procedures for identifying and managing its risk exposures' (responsibilities 2.19, 2.18b, 2.21 and 2.29, respectively). As noted in chapter six in relation to the UK, commercial organisations are increasingly dependent on their computer systems for all aspects of their current operations and future planning. Additionally, to some extent in all organisations but especially in listed companies (that are subject to the Stock Exchange's corporate governance requirements), increased emphasis has been (and is being) placed on internal non-financial (as well as financial) internal controls, and on procedures for identifying and managing risks. Further, the increasingly competitive, complex and dynamic nature of the current business environment has prompted greater need for efficient and effective corporate management. Hence, intuitively it might be expected that the benefits to be derived from auditors providing assurance to interested parties about these matters would outweigh the costs involved. Nevertheless none of the four responsibilities (*ie.* 2.19, 2.18b, 2.21 and 2.29) met the research's cost-benefit criterion to qualify as responsibilities that are reasonable to expect of auditors. This finding may result from the fact that these issues are still relatively new and the beneficial role that auditors could play by providing assurance in these regards has not yet been widely recognised. However, it may also be that NZ society (represented by the 'society group') has yet to recognise that auditors – working in multi-disciplinary audit teams – are able to provide objective assurance on such matters and that they perceive auditors' competence to be limited to expressing an opinion on auditees' financial statements. Such a perception may have been heightened by the apparent reluctance by the auditing profession in NZ (facing an increasingly litigious society) to accept extended responsibilities and to broaden auditors' role in society. This reluctance is reflected, *inter alia*, in the limited number and scope of responsibilities the auditor group identified as those they should perform, see Table 8.5.

A further responsibility whose failure to qualify as a responsibility reasonably expected of auditors is not readily explainable is: 'to report to the Inland Revenue Department breaches of tax law discovered during an audit' (2.7). This responsibility clearly falls within auditors' expertise and, given that the tax information presented in the financial statements must be audited, the performance of this responsibility seems unlikely to involve significant additional audit cost. Further, benefits from increased social spending could be expected to ensue from the resultant increase in government revenues. However, in NZ (as in the UK) there appears to be fairly widespread aversion to the Inland Revenue Department and a sense that tax avoidance is, in general, 'fair game'. It thus appears that the principal costs resulting from auditors performing this responsibility lie in the adverse impact it would have on auditor-client relations which may result in reduced client co-operation and, therefore, in increased audit time and cost. On balance, it seems that the social and economic costs attaching to auditors performing this duty are adjudged to outweigh the social and economic benefits likely to be gained.

The deficient standards gap

It was noted earlier that, of the 41 responsibilities identified by 20% or more of the society group as responsibilities auditors should perform, 18 do not meet the cost-benefit criterion and that these responsibilities constitute the 'reasonableness gap' component of the audit expectation-performance gap. Of the remaining 23, nine are existing responsibilities of auditors in NZ; the other 14 are reasonably expected but not (yet) required of auditors. These 14 responsibilities comprise the 'deficient standards' portion of the 'performance gap'[8]. They are as follows:

- to disclose the fact in the audit report if during an audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees, or that the directors or senior management have embezzled organisational assets or committed other illegal acts which directly impact on the financial statements (such as bribery and political payoffs) (2.12b, 2.12c, 2.15a);
- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the SFO, police or Registrar of Companies), if during an audit it is discovered that:
  - the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts,
  - information presented in the financial statements has been deliberately distorted,

  or suspicious circumstances are encountered suggesting that theft or deliberate distortion of financial information may have occurred (2.11c, 2.16, 2.11d and 2.13,);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls, the reasonableness of financial forecasts included in its annual report, and the reliability of information contained in its entire annual report – in particular, about its directors' and senior executives' remuneration policy and record (2.18a, 2.23, 2.26a and 2.17d);
- to audit half-yearly published financial statements (2.22a);
- to examine a listed company auditee's compliance with the Stock Exchange's governance requirements and to report (in the audit report) whether or not it has complied with those requirements (2.27a); and
- to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing its risk exposures (2.28).

Reviewing these responsibilities, it may be seen that seven of the 14 involve disclosing in the audit report, or privately to an appropriate authority, matters of concern (such as theft, other illegal acts, and deliberately distorted information) that are discovered during an audit (responsibilities 2.11c, 2.11d, 2.12b, 2.12c, 2.13, 2.15a and 2.16). The information to be disclosed is already within auditors' knowledge. Thus, it seems likely that extending their responsibilities to embrace these reporting requirements would result in little additional audit cost and that these costs would be more than outweighed by the benefits to society that would ensue. However, as noted in chapter six in relation to the UK, before these responsibilities are imposed on auditors, the 'appropriate authority' to whom auditors should report needs to be clarified, and legal protection provided for auditors against possible claims of breach of client confidentiality and/or defamation of character, when they report matters of concern in good faith and on reasonable grounds.

A further six of the 14 responsibilities relate to corporate accountability and corporate governance issues. The society group signified that auditors should be required to provide assurance to external parties (through the audit report) about the 'truth and fairness' of auditees' published half-yearly financial statements, and the reliability of information provided in their entire annual reports – in particular, about their directors' and senior executives' remuneration (responsibilities 2.22a, 2.26a, 2.17d). The group also indicated that auditors should report (in the audit report) on the effectiveness of auditees' internal financial controls and, in the case of listed companies, on their compliance with the Stock Exchange's corporate governance requirements. Additionally they should report privately to the directors on the adequacy the auditee's risk management procedures (2.27a, 2.18a and 2.28).

It is clear from media reports that, in the current era of well-publicised instances of distorted reporting by some major companies (such as Enron, WorldCom and Xerox), and disreputable, dishonest and/or unconscionably reckless acts by the directors or senior executives of these or other major companies, in NZ (as in the UK and elsewhere) politicians, regulators, the financial community and the public expect auditors to play a more active role in securing greater corporate accountability and responsible corporate governance. The survey finding that the responsibilities outlined above qualify as responsibilities reasonably expected of auditors reflects the expectations of these parties. Although, under existing auditing standards, auditors are not required to perform these responsibilities, it is evident that such a requirement would be widely supported by auditors' interest groups (*ie.* auditees, and both financial and non-financial community audit beneficiaries).

As in the UK, in NZ identification of the responsibility: 'to examine and report (in the audit report) on the reasonableness of financial forecasts included in the auditee's annual report' (responsibility 2.23) as a responsibility reasonably expected of auditors accords with the emphasis given by NZ's Financial Reporting Board to the value of future-oriented, rather than historic, financial information for economic decision making. In this context, financial forecasts are clearly beneficial. However, their credibility – and hence their value – would be significantly increased if external auditors examined and reported on their reasonableness (or otherwise). Although performing this responsibility is likely to involve additional audit work, the survey findings suggest that the increment in costs would be outweighed by the resulting benefits.

Summary and key issues

This chapter has reported the findings of the portion of the research conducted in NZ in 1999. The responsibilities the interest groups believed to be existing responsibilities of auditors have been identified and it was shown that, while auditors are relatively knowledgeable about their existing responsibilities, the knowledge of their interest groups decreases as distance from the audit function increases. Non-financial community audit beneficiaries appear to have very limited knowledge about auditors' existing responsibilities.

The responsibilities the interest groups considered auditors should perform have also been reported and it was noted that the further an interest group is from the audit function, the greater the number and range of responsibilities the group signified auditors should perform. While the auditor group recognised a limited set of responsibilities as those they should perform, the non-financial community group signified that auditors should perform a very wide range of responsibilities.

As for the UK portion of the research, four key components of the audit expectation-performance gap, namely, 'society's expectations of auditors', the 'responsibilities reasonably expected of auditors', the 'reasonableness gap', and the 'deficient standards' portion of the 'performance gap'[9], were derived from the responsibilities 20% or more of the society group (*ie.* all non-auditor respondents) identified as those auditors should perform.

In NZ in 1999, 41 of the suggested responsibilities of auditors included in the questionnaire constituted 'society's expectations of auditors'. Applying the cost-benefit criterion adopted for the research, 23 of the 41 were found to be responsibilities reasonably expected of auditors. Thus, 18 responsibilities were *un*reasonably expected of auditors; these constitute the reasonableness gap. Reviewing the 18 responsibilities, it was found that the failure of some to qualify as 'reasonably expected of auditors' is fairly readily explained: this group includes the responsibilities 'to guarantee that the auditee's financial statements are completely accurate' and 'an auditee whose financial statements receive an unqualified audit report is financially sound'. The failure of others to qualify as cost-effective is less easily explained – for example, 'to report to the Inland Revenue Department breaches of tax law discovered during an audit', and 'to report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet'.

Of the 23 responsibilities reasonably expected of auditors, nine are existing responsibilities. The remaining 14, although reasonably expected, are not currently required of auditors: these constitute the 'deficient standards' portion of the 'performance gap'. Seven of the 14 involve auditors reporting – either in the audit report or to an appropriate authority – matters of concern (such as fraud or other illegal acts by the auditee's senior officials) they discover during the audit. A further six relate to corporate accountability and corporate governance issues and they signal an enhanced role for auditors in this arena.

This chapter has also reported the survey groups' assessment of auditors' performance of their nine existing responsibilities. While auditors considered that their performance of all nine responsibilities is satisfactory, the other groups were more critical: the financial community audit beneficiaries signalled the highest level of dissatisfaction with auditors' performance.

The society group's assessment of auditors' performance of their existing responsibilities provided the means for determining the composition of the 'deficient performance' portion of the 'performance gap'. This group signified that auditors perform five of their nine existing responsibilities deficiently. These five duties constitute the deficient performance gap.

Key findings of this portion of the research include the following:

- The greater the distance of a survey group is from the audit function, the less its knowledge about auditors' existing responsibilities and the greater the number and range of responsibilities it expects auditors to perform. It seems that non-financial community audit beneficiaries (the group most remote from the audit function) expect auditors to fulfil a very broad role in society.
- Forty-one responsibilities constitute 'society's expectations of auditors' and, of these, based on the application of a cost-benefit criterion, 23 are reasonable to expect of auditors.
- Eighteen of the responsibilities comprising 'society's expectations of auditors' fail the cost-benefit test and are, therefore, unreasonably expected of auditors. These responsibilities comprise the 'reasonableness gap' component of the audit expectation-performance gap.
- Of the 23 responsibilities reasonably expected of auditors, nine are existing responsibilities: the remaining 14 are reasonably expected but not currently required of auditors. These 14 responsibilities constitute the 'deficient standards' portion of the 'performance gap' component of the audit expectation-performance gap.
- Although auditors consider that they perform all nine of their existing responsibilities to a satisfactory standard, the society group consider that five are performed deficiently. These five responsibilities constitute the 'deficient performance' portion of the 'performance gap'.

Endnotes:

[1] As in the UK the initial mailing was followed up by two further mailings to non-respondents at approximately monthly intervals. The responses received from the initial and two subsequent mailings were tested for non-response bias but no differences in the responses were detected.

[2] It should be recalled from chapter three that where the mean of a group's responses is positive this signifies that the group considered the responsibility is an existing responsibility of auditors. The converse applied where the mean of a group's responses is negative.

[3] The information is presented as an appendix to this report as it is supplementary to the information presented in Table 8.2. Further, while the knowledge gap of 'the society group' (that is, all non-auditors) is of relevance to the 'reasonableness' component of the audit expectation-performance gap (as discussed in Chapter 6), it is not a component of it.

[4] This result should be interpreted with caution for reasons explained in chapter four, endnote five.

[5] That is, responsibilities 2.11c, 2.11d, 2,12b, 2.12c, 2.13, 2.15a, 2.16 and 2.18a (see list above).

[6] It should be recalled from chapter six that the responses of these two interest groups indicating the responsibilities auditor should perform were adopted, for the purposes of the research, as a surrogate for cost-benefit analysis.

[7] As evidenced by the increased incidence and extent of reporting by major companies in their in annual or stand-alone reports on their corporate social responsibility and related activities.

[8] It should be recalled from chapter two that the audit expectation-performance gap is constituted by the 'reasonableness' and 'performance' gaps and that the latter may be subdivided into the 'deficient standards and deficient performance portions.

[9] See endnote eight.

Chapter Nine

Audit Expectation-Performance Gap in New Zealand in 1999 – and Comparison With the Gap in New Zealand in 1989 and United Kingdom in 1999

In this chapter the survey results discussed in chapter eight are summarised and presented diagrammatically. Additionally, the audit expectation-performance gap as it was found to exist in NZ in 1999 is compared with that pertaining in NZ a decade earlier, in 1989. The audit expectation-performance gaps in NZ and the UK in 1999 are also compared and discussed.

Audit expectation-performance gap in NZ in 1999

The survey findings reported in chapter eight are summarised in Table 9.1 and Figure 9.1. (These follow the same format as Tables 7.1 and 7.2 and Figures 7.1 and 7.2 in Chapter 7). In Table 9.1, the responsibilities comprising 'society's expectations of auditors' are denoted 'S' in the column headed 'Duties expected of auditors'. Similarly, the responsibilities reasonably expected of auditors and auditors' existing responsibilities are denoted 'RE' and 'D', respectively, in appropriately headed columns.

Reasonableness gap

Among the responsibilities constituting 'society's expectations of auditors', 18 were found not to be cost-effective for auditors to perform. These responsibilities, which are unreasonably expected of auditors, comprise the 'reasonableness gap'. They are represented in Table 9.1 in the column headed 'Reasonableness gap duties'. At least 20% of the society group indicated that they expect auditors to perform each of these responsibilities and, notwithstanding that their expectations are unreasonable, the non-performance of these responsibilities leaves a significant proportion of society (represented by the research's society group) with unfulfilled expectations. The level of unfulfilled expectations attaching to each responsibility is reflected in the proportion of the society group who signified that they expect auditors to perform the responsibility in question. The relevant proportions (expressed as percentages) are shown in Table 9.1 and Figure 9.1.

From the level of unfulfilled expectations attaching to each responsibility, the relative contribution of the responsibility to the total level of unfulfilled expectations constituting the 'reasonableness gap' may be calculated. The relative contribution of each responsibility is shown in Figure 9.1. From this it may be seen that five responsibilities comprise some 36% of the reasonableness gap. These are the responsibilities:

- to report privately to an appropriate authority (such as the Registrar of Companies) doubts about the continued existence of the auditee, or if during an audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees (2.5a and 2.11b);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls (2.18b);
- to guarantee that an auditee whose financial statements receive an unqualified audit report is financially sound (2.4);
- to detect illegal acts by the auditee's directors or senior management which only indirectly impact on the financial statements (such as breaches of occupational safety and environmental laws and regulations) (2.14b).

Table 9.1 Contribution of responsibilities to components of the audit expectation-performance gap in NZ, 1999

Resp No.		Perform-ance gap duties	Existing duties of auditors	Deficient standards gap duties	Duties reasonably expected of auditors	Reason-ableness gap duties	Duties expected of auditors
	Suggested responsibilities of auditors[1]	%[2]		%[2]		%[2]	
2.1	Prepare auditee's financial statements	–	–	–	–	–	–
2.2	Guarantee auditee's financial statements are accurate	–	–	–	–	38	S
2.3	State whether auditee's financial statements fairly reflect its financial affairs	–	D	–	RE	–	S
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	–	–	–	–	42	S
2.5a	Report to an appropriate authority (*eg* Registrar of Cos or Reserve Bank) doubts about auditee's continued existence	–	–	–	–	44	S
2.5b	Disclose in audit report doubts about auditee's continued existence	20	D	–	RE	–	S
2.6	Ensure compliance with relevant legislation	–	D		RE	–	S
2.7	Report breaches of tax law to Inland Revenue Department	–	–	–	–	30	S
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	17	D	–	RE	–	S
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	21	D	–	RE	–	S
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	34	S
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	–	–	–	–	38	S
2.10	Detect deliberate distortion of auditee's financial statements	–	D	–	RE	–	S
2.11a	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	29	S
2.11b	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), theft of material amount of auditee's assets by non-managerial employees	–	–	–	–	51	S
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), embezzlement of auditee's assets by directors/senior management	–	–	70	RE	–	S
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), deliberate distortion of auditee's financial statements	–	–	66	RE	–	S
2.12a	Disclose in the audit report minor (but not petty) theft of auditee's assets by non-managerial employees	–	–	–	–	32	S
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	–	–	61	RE	–	S
2.12c	Disclose in the audit report embezzlement of auditee's assets by directors/senior management	–	–	77	RE	–	S
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	19	D	–	RE	–	S
2.13	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) suspicions of theft or deliberate distortion of auditee's financial statements	–	–	52	RE	–	S
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	17	D	–	RE	–	S
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	–	–	–	–	42	S
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on auditee's financial statements	–	–	74	RE	–	S
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	–	–	–	–	39	S

2.16	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) illegal acts committed by auditee's officials	–	–	58	RE	–	S
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	–	–	–	–	–	–
2.17b	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its product safety policy and record	–	–	–	–	–	–
2.17c	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its occupational health and safety policy and record	–	–	–	–	20	S
2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its directors/senior executives' remuneration policy and record	–	–	47	RE	–	S
2.18a	Examine and report (in the audit report) on the effectiveness of auditee's internal financial controls	–	–	63	RE	–	S
2.18b	Examine and report (in the audit report) on the effectiveness of auditee's internal non-financial controls	–	–	–	–	43	S
2.19	Examine and report (in the audit report) on auditee's IT systems	–	–	–	–	28	S
2.20	Examine and report (in the audit report) on auditee's non-financial performance	–	–	–	–	–	–
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	–	–	–	–	27	S
2.22a	To audit half-yearly published financial statements	–	–	48	RE	–	S
2.22b	To audit quarterly published financial statements	–	–	–	–	29	S
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	–	–	57	RE	–	S
2.24a	Consider and report (in audit report) on the impact of auditee on its local community	–	–	–	–	–	–
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	–	–	–	–	–	–
2.25	Verify every transaction of the auditee	–	–	–	–	–	–
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	–	–	48	RE	–	S
2.26b	Examine and report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements	–	D	–	RE	–	S
2.27a	For listed company auditees, examine compliance with Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	–	–	48	RE	–	S
2.27b	For listed company auditees, examine compliance with Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	Subsumed by 2.27a (All non-auditors indicating auditors should perform 2.27b also answered 'yes' to 2.27a					
2.28	Examine and report privately to auditee's directors on adequacy of the auditee's risk management procedures	–	–	63	RE	–	S
2.29	Examine and report (in the audit report) on the adequacy of auditee's risk management procedures	–	–	–	–	38	S
2.30	Examine and report (in attached audit report) on reliability of auditee's financial information on the Internet	–	–	–	–	33	S
No. of responsibilities		5	9	14	23	18	41
Measure of unfulfilled expectations attaching to component		94	–	832	–	637	–
Proportion of expectation-performance gap		6%		53%		41%	

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.
[2] Percentage of non-auditor respondents signifying the responsibility is poorly performed, or that the responsibility should be performed by auditors, as applicable.
D Existing duty of auditors, identified by reference to Statute law, Case law and professional promulgations.
RE Responsibilities expected of auditors which are cost-beneficial for auditors to perform.
S Responsibility identified by 20% or more of a non-auditor interest group as a responsibility auditors should perform.

Figure 9.1 The relative contribution of duties to components and of components to the audit expectation-performance gap in NZ, 1999

(Please note: The key to responsibilities identified by number is presented in table 9.1)[7]

Auditors Perceived Performance[1]

Audit Expectation-Performance Gap

Society's Expectations of Auditors[2]

Performance Gap

Reasonableness Gap

Auditors' Existing Responsibilities[3]

Duties Reasonably Expected of Auditors[4]

Deficient Performance — 6%

Deficient Standards — 53%

Unreasonableness Expectations — 41%

Deficient Performance (6%)

Duty	Response %[5]	Contrib %[6]
2.8b	21	23
2.5b	20	21
2.12d	19	20
2.8a	17	18
2.14a	17	18
	94	**100**

Deficient Standards (53%)

Duty	Response %[5]	Contrib %[6]
2.12c	77	9
2.15a	74	9
2.11c	70	8
2.11d	66	8
2.18a	63	8
2.28	63	8
2.12b	61	7
2.16	58	7
2.23	57	7
2.13	52	6
2.22a	48	6
2.26a	48	6
2.27a	48	6
2.17d	47	5
	832	**100**

Unreasonableness Expectations (41%)

Duty	Response	Contrib	Duty	Response %[5]	Contrib %[6]
2.11b	51	8	2.30	33	5
2.5a	44	7	2.12a	32	5
2.18b	43	7	2.7	30	5
2.4	42	7	2.11a	29	5
2.14b	42	7	2.22b	29	5
2.15b	39	6	2.19	28	4
2.2	38	6	2.21	27	3
2.9b	38	6	2.17c	20	3
2.29	38	6			
2.9a	34	5			
				637	**100**

1 Auditors' duties perceived by the society group to be performed deficiently.
2 Duties expected of auditors by 20% or more of a non-auditor interest group.
3 Existing duties defined by reference to the statute law, case law and professional promulgations.
4 Duties which are cost-beneficial for auditors to perform.
5 Proportion of the society group (non-auditor respondents) whose expectations with respect to the duty are not being fulfilled.
6 Relative contribution of duties to the component.

Deficient standards portion of the performance gap

Responsibilities that are elements of 'society's expectations of auditors' which meet the cost-benefit criterion to be reasonably expected of auditors – but which are not among their existing responsibilities – constitute the 'deficient standards' portion of the 'performance gap' (see Figure 9.1). These are represented in the column headed 'Deficient standards gap duties' in Table 9.1. As for the reasonableness gap responsibilities, the proportion of the society group who signified that they expect auditors to perform these responsibilities have unfulfilled expectations as a result of their non-performance. The extent of society's unfulfilled expectations attaching to each responsibility is reflected in the proportion of the society group who indicated that they expect auditors to perform the responsibility. These proportions (expressed as percentages) are shown in Table 9.1 and Figure 9.1. From these proportions, the relative contribution of each responsibility to the deficient standards gap may be calculated. These are also shown in Figure 9.1.

From Figure 9.1 it may be seen that the following six responsibilities comprise 50% of the deficient standards gap:

- to disclose the fact in the audit report if during an audit it is discovered that the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts which directly impact on the financial statements (such as bribery or political payoffs) (2.12c and 2.15a);
- to report privately to an appropriate authority (such as the SFO, police or Registrar of Companies) if during an audit it is discovered that the financial statements have been deliberately distorted or that the directors or senior management have embezzled organisational assets (2.11d and 2.11c);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls (2.18a);
- to examine and report privately to the auditee's directors on the adequacy of procedures for identifying and managing its risk exposures (2.28).

As noted in relation to the deficient standards gap responsibilities in the UK, if auditors were required to perform some or all of these responsibilities, this would go some way towards narrowing the gap between society's expectations of auditors and auditors' performance.

Deficient performance portion of the performance gap

The responsibilities comprising the 'deficient performance' portion of the 'performance gap' are shown in the column headed 'Deficient performance gap duties' in Table 9.1. Each responsibility was identified from the mean of the society group's responses signifying sub-standard performance of the responsibility and/or by 20% or more of the society group indicating that, in their view, auditors perform the responsibility poorly (see Chapter 8).

Given that a significant proportion of the society group signalled dissatisfaction with auditors' performance of each of the deficient performance gap duties, it is clear that unfulfilled expectations attach to each responsibility. The relative level of unfulfilled expectations attaching to each responsibility is reflected in the proportion of the society group who assessed auditors' performance of the responsibility as poor. These proportions (expressed as percentages) are shown in Figure 9.1. From these proportions, the relative contribution of each responsibility to the deficient performance gap may be calculated. These are also shown in Figure 9.1.

From the relative contribution of each responsibility, it may seen that 44% of the deficient performance gap is derived from two responsibilities, namely:

- to detect the theft of a significant amount of auditee assets by the directors or senior management (2.8b);
- to disclose in the audit report doubts about the auditee's continued existence (2.5b).

Contribution of components to the audit expectation-performance gap in NZ in 1999

As explained in chapter seven, from the level of unfulfilled expectations attaching to each responsibility comprising the reasonableness, deficient standards, and deficient performance gaps (derived from the proportion of the society group who signified that they expect auditors to perform the responsibility, or that auditors perform the responsibility poorly, as applicable), the total level of unfulfilled expectations constituting each component of the audit expectation-performance gap may be calculated. Additionally, from the total of unfulfilled expectations attaching to each component of the audit expectation-performance gap, the relative contribution of each component to the audit expectation-performance gap overall may be determined. (The relevant figures are presented at the foot of Table 9.1 and in Figure 9.1).

From Figure 9.1 it may be seen that in NZ in 1999, the reasonableness gap contributed 41% of the audit expectation-performance gap, the deficient standards gap 53%, and the deficient performance gap just 6%.

Comparison of the audit expectation-performance gap in New Zealand in 1999 and 1989

Comparing Figure 9.1 and Figure 7.2 (in Chapter 7, which provides a diagrammatic representation of the audit expectation-performance gap in NZ in 1989), the most striking features are the change in the relative contributions of the components to the audit expectation-performance gap overall, and the significant increase in the number of responsibilities comprising the 'deficient standards' and 'reasonableness' gaps.

Between 1989 and 1999, the contribution of the deficient performance and deficient standards portions of the performance gap to the audit expectation-performance gap fell from 11% to 6% and from 58% to 53%, respectively (an overall reduction in the performance gap of 10% (from 69% to 59%): the contribution of the reasonableness gap increased correspondingly, from 31% to 41%. At the same time, the number of responsibilities comprising the deficient standards gap increased from ten to 14, and those constituting the reasonableness gap doubled, from nine to 18.

Although auditors' performance appears to have improved over the decade from 1989 to 1999, the resultant narrowing of the audit expectation gap has been more than offset by an extension of society's expectations of auditors. Overall, the expectation-performance gap has widened from 1,140 units of unfulfilled expectations in 1989 to 1,563 units in 1999; an increase of 37% (see Figures 7.2 and 9.1).

Changes in the deficient performance gap 1989-1999

The research findings suggest that NZ society considers that auditors' performance of their existing responsibilities improved quite markedly between 1989 and 1999. This is reflected not only in the reduced contribution of the deficient performance component to the audit expectation-performance gap, but also in the total level of unfulfilled expectations attaching to the component: these fell from 125 units in 1989 to 94 units in 1999; a decrease of nearly 25% (see Figures 7.2 and 9.1)

However, notwithstanding this apparent improvement in auditors' performance, it should be noted that the same five responsibilities that constituted the deficient performance gap in 1989 also did so in 1999. Nevertheless, the level of unfulfilled expectations attaching to each responsibility fell over the decade, with the exception of the responsibility 'to detect the theft of a significant amount of auditee assets by the directors or senior management' (2.8b). Auditors' performance of this responsibility was assessed as poor by 21% of the society group in both 1989 and 1999. The apparent improvement in auditors' performance of their responsibility 'to disclose in the audit report doubts about the continued existence of the auditee' (2.5b) is particularly notable. The proportion of the society group signifying that auditors' performance of this responsibility is poor, fell from 37% in 1989 to 20% in 1999.

As in the UK, since 1989, both monitoring of auditors' performance by the auditing profession, and a revised (more demanding) auditing standard on assessing the going concern status of an auditee (Auditing Standard 520: *Going concern*), have been introduced in NZ. It is suggested that these developments may well be responsible, at least in part, for the apparent improvement in auditors' performance of their responsibilities.

Changes in the deficient standards gap 1989-1999

As noted earlier, the contribution of the deficient standards gap to the overall audit expectation-performance gap decreased from 58% in 1989 to 53% in 1999. However, the number of responsibilities constituting the deficient standards gap increased from ten to 14, and society's unfulfilled expectations attaching to this component of the audit expectation-performance gap increased from 667 units in 1989 to 832 units in 1999; an increase of nearly 25% (see Figures 7.2 and 9.1).

Analysing the responsibilities that comprised the deficient standards gap in 1989 and 1999, it may be seen that nine of the ten responsibilities constituting the gap in 1989 also contributed to it in 1999. The exception was the responsibility: 'to report privately to an appropriate authority (such as the Registrar of Companies) doubts about the continued existence of the auditee' (2.5a). By 1999 this responsibility had changed its status from being reasonably, to unreasonably, expected of auditors (from an element of the deficient standards gap to that of the reasonableness gap). It may be that, as society perceives auditors to be better reporting their doubts about the continued existence of an auditee in their audit reports (see above), fewer benefits are perceived as likely to ensue from them also reporting their doubts privately to an appropriate authority. Thus, a responsibility that was adjudged to be cost-effective for auditors to perform in 1989 was considered not to be so in 1999.

The other five responsibilities contributing to the deficient standards gap in 1999, but not in 1989, relate to issues that were not significant in the auditing arena of NZ in 1989. Three of these concern corporate accountability and corporate governance matters, namely:

- to report privately to the auditee's directors on the adequacy of procedures for identifying and managing its risk exposures (2.28);
- to examine and report on the reliability of information contained in the auditee's entire annual report (2.26a); and
- to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report whether or not it has complied with those requirements (2.27a).

The remaining two responsibilities that contributed to the deficient standards gap in 1999, but not in 1989, were expressed as separate responsibilities in the 1999 survey instrument but were elements of more generally stated responsibilities in 1989. They are as follows:

- to disclose the fact in the audit report if during an audit it is discovered that minor (but not petty) theft of auditee assets has been committed by non-managerial employees (responsibility 2.12b in 1999). In 1989, the single, more general, responsibility referred to 'the theft of auditee assets by non-managerial employees', without distinguishing between minor and material theft of auditee assets; and
- to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its directors' and senior executives' remuneration policy and record (responsibility 2.17d in 1999). In 1989 the single, more general, responsibility referred to 'the reliability of non-financial information presented in the auditee's annual report', without specifying particular types of non-financial information.

In 1989, both of these responsibilities, in their general form, contributed to the reasonableness gap.

Changes in the reasonableness gap 1989-1999

Unlike the deficient performance and deficient standards gaps, the contribution of the reasonableness gap to the audit expectation-performance gap increased over the decade from 1989 to 1999 (from 31% to 41%). However, of greater significance is the doubling (from nine to 18) of the responsibilities constituting the reasonableness gap and the marked increase in society's unfulfilled expectations attaching to this component of the audit expectation-performance gap (from 348 units in 1989 to 637 units in 1999: see Figures 7.2 and 9.1).

These increases reflect a broadening of society's expectations of auditors between 1989 and 1999 – primarily resulting from a growth in society's demand for greater corporate accountability and more responsible corporate governance and for auditors to play a more significant role in these areas. As noted in chapter eight, these changes have been stimulated, in particular, by well-publicised reports of deliberately distorted reporting by some major companies, and by disreputable, dishonest and/or reckless acts by senior officials in these and other companies.

Of the nine responsibilities that comprised the reasonableness gap in NZ in 1989, six reappeared as elements of the gap in 1999 (namely, responsibilities 2.2, 2.4, 2.7, 2.14b, 2.15b and 2,21: see Tables 7.2 and 9.1). The other three were expressed as single responsibilities in 1989 but, reflecting developments in the audit environment in NZ between 1989 and 1999, each of the three was expressed as two or more separate responsibilities in 1999. Four responsibilities that contributed to the reasonableness gap in 1999 were derived from these three single 1989 responsibilities. They are as follows:

- to report privately to an appropriate authority (such as the SFO, police, or Registrar of Companies) if during an audit it is discovered that minor (but not petty) theft, or theft of a significant amount, of auditee assets has been committed by non-managerial employees (responsibilities 2.11a and 2.11b in 1999). In 1989, the single responsibility (2.11) referred to reporting privately to an appropriate authority theft of assets by non-managerial employees, without distinguishing between minor and material theft;
- to disclose the fact in the audit report if during the audit it is discovered that minor (but not petty) theft of auditee assets has been committed by non-managerial employees (responsibility 2.12a in 1999). In 1989, the single responsibility (2.12) referred to disclosing in the audit report theft of assets by non-managerial employees, without distinguishing between minor and material theft[1]; and
- to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its occupational health and safety policy and record (responsibility 2.17c in 1999). In 1989 the single responsibility (2.17) referred to auditors examining and reporting on the reliability of non-financial information, without identifying any specific types of such information[2].

Seven other responsibilities that contributed to the reasonableness gap in 1999 did not feature in the 1989 survey instrument. These responsibilities relate to corporate governance and accountability matters or to computer technology – issues that were not particularly significant in the audit environment of NZ in 1989. The responsibilities concerned are as follows:

- to detect minor (but not petty) theft of auditee assets by non-managerial employees, or by the directors or senior management (2.9a and 2.9b);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls (2.18b);
- to report privately to the auditee's directors about the adequacy of procedures for identifying and managing its risk exposures (2.29);
- to audit quarterly published financial statements (2.22b);
- to examine and report (in the audit report) on the auditee's computer systems (2.19); and
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee in on the internet (2.30).

The remaining responsibility that featured as an element of the reasonableness gap in 1999, namely, 'to report privately to an appropriate authority (such as the Registrar of Companies) doubts about the continued existence of the auditee' (2.5a), contributed to the deficient standards gap in 1989. As noted above in relation to the deficient standards gap, the change in status of this responsibility may be linked to NZ society adjudging auditors' performance of their duty 'to disclose in the audit report doubts about the continued existence of the auditee' (2.5b) in 1999 to be significantly better than in 1989 and, as a result, fewer benefits were perceived as likely to ensue from auditors also reporting their doubts privately to an appropriate authority. Hence, while the responsibility met the cost-benefit criterion in 1989, it did not do so in 1999 (thus, it changed from being reasonably, to unreasonably, expected of auditors).

Comparison of the audit expectation-performance gap in the UK and NZ in 1999

Comparing Figure 7.1 (in Chapter 7) and Figure 9.1, which depict the extent and composition of the audit expectation-performance gap in 1999 in the UK and NZ, respectively, it may be seen that the extent of the gap in each country is very similar. In the UK, it is constituted by 1591 units of society's unfulfilled expectations compared with 1563 units of unfulfilled expectations in NZ (a difference of less than 2%). Nevertheless, as may be seen from Table 9.2 and by comparing Figures 7.1 and 9.1, the contribution of the gap's components differs quite markedly between the two countries. While in the UK, the reasonableness, deficient standards and deficient performance gaps comprise 50%, 42%, and 8% of the audit expectation-performance gap, respectively, the comparative proportions for the audit expectation-performance gap in NZ are 41%, 53% and 6%.

Comparison of the deficient performance gap in the UK and NZ in 1999

In 1999 in NZ, the deficient performance gap consisted of five responsibilities (with 94 units of unfulfilled expectations[3] attached). The same five responsibilities were included among the seven responsibilities that constituted the deficient performance gap (comprising 131 units of unfulfilled expectations) in the UK. These five responsibilities are as follows:

- to detect the theft of a significant amount of auditee assets by non-managerial employees, or by the directors or senior management (2.8a and 2.8b);
- to detect illegal acts committed by the auditee's directors or senior management which directly impact on its financial statements (2.14a);
- to disclose in the audit report doubts about the continued existence of the auditee, or if during the audit it is discovered that information presented in the financial statements has been deliberately distorted (2.5b and 2.12d).

It is striking that the level of unfulfilled expectations attaching to these five responsibilities in the UK and NZ are remarkably similar and that none of the differences are statistically significant (see Table 9.2).

The two responsibilities that contributed to the deficient performance gap in the UK, but not in NZ, namely: 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority if during the audit it is discovered that the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts' (2.11c and 2.16), were existing responsibilities in the UK but not in NZ (and, therefore, by definition could not feature in the deficient performance gap in NZ). These two responsibilities account for most of the difference in the extent of the deficient performance gap in the two countries: 13% and 17%, respectively, of the society group in the UK indicated that auditors perform these responsibilities poorly – thus these responsibilities contributed 30 of the 37 units of unfulfilled expectations by which the deficient performance gap in the UK exceeded that in NZ.

Table 9.2 ***Comparison of composition of components of audit expectation-performance gap in UK & NZ, 1999***

Resp No.	Suggested responsibilities of auditors[1]	Performance gap duties		Deficient standards gap duties		Reasonableness gap duties	
		UK	*NZ*	UK	*NZ*	UK	*NZ*
		%[2]	%[2]	%[2]	%[2]	%[2]	%[2]
2.1	Prepare auditee's financial statements	-	-	-	-	26	-
2.2	Guarantee auditee's financial statements are accurate	-	-	-	-	37*	38*
2.3	State whether auditee's financial statements fairly reflect its financial affairs‡	-	-	-	-	-	-
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	-	-	-	-	45*	42*
2.5a	Report to an appropriate authority (*eg* DTI or FSA) doubts about auditee's continued existence	-	-	53	-	-	44
2.5b	Disclose in the audit report doubts about auditee's continued existence	23*	20*	-	-	-	-
2.6	Ensure compliance with relevant legislation‡	-	-	-	-	-	-
2.7	Report breaches of tax law to Inland Revenue	-	-	-	-	48	30
2.8a	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by non-managerial employees	21*	17*	-	-	-	-
2.8b	Detect theft of material amount (*eg* > 5% of turnover or total assets) of auditee's assets by directors/senior management	22*	21*	-	-	-	-
2.9a	Detect minor (but not petty) theft of auditee's assets by non-managerial employees	-	-	-	-	27	34
2.9b	Detect minor (but not petty) theft of auditee's assets by directors/senior management	-	-	-	-	34*	38*
2.10	Detect deliberate distortion of auditee's financial statements‡	-	-	-	-	-	-
2.11a	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI/Registrar of Cos), minor (but not petty) theft of auditee's assets by non-managerial employees	-	-	-	-	25*	29*
2.11b	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI/Registrar of Cos), theft of material amount of auditee's assets by non-managerial employees	-	-	-	-	53*	51*
2.11c	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of auditee's assets by directors/senior management	13	-	-	70	-	-
2.11d	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI/Registar of Cos), deliberate distortion of auditee's financial statements	-	-	75	66	-	-
2.12a	Disclose in the audit report minor (but not petty) theft of auditee's assets by non-managerial employees	-	-	-	-	23	32
2.12b	Disclose in the audit report theft of material amount of auditee's assets by non-managerial employees	-	-	64*	61*	-	-
2.12c	Disclose in the audit report embezzlement of auditee's assets by directors/ senior management	-	-	82*	77*	-	-
2.12d	Disclose in the audit report deliberate distortion of auditee's financial statements	17*	19*	-	-	-	-
2.13	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) suspicions of theft or deliberate distortion of auditee's financial statements	-	-	62	52	-	-
2.14a	Detect illegal acts by auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	18*	17*	-	-	-	-
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	-	-	-	-	33	42
2.15a	Disclose in the audit report illegal acts by auditee's officials which directly impact on auditee's financial statements	-	-	79*	74*	-	-
2.15b	Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	-	-	-	-	36*	39*

2.16	In absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts committed by auditee's officials	17	–	–	58	–	–
2.17a	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its equal employment opportunities policy and record	–	–	–	–	20	–
2.17b	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its product safety policy and record	–	–	–	–	21	–
2.17c	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its occupational health and safety policy and record	–	–	–	–	21⋆	20⋆
2.17d	Examine and report (in the audit report) on the reliability of information in auditee's annual report about its directors/senior executives' remuneration policy and record†	–	–	–	47	–	–
2.18a	Examine and report (in the audit report) on the effectiveness of auditee's internal financial controls	–	–	79	63	–	–
2.18b	Examine and report (in the audit report) on the effectiveness of auditee's internal non-financial controls	–	–	–	–	41⋆	43⋆
2.19	Examine and report (in the audit report) on auditee's IT systems	–	–	–	–	34	28
2.20	Examine and report (in audit report) on auditee's non-financial performance	–	–	–	–	–	–
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administration	–	–	–	–	25⋆	27⋆
2.22a	To audit half-yearly published financial statements	–	–	–	48	46	–
2.22b	To audit quarterly published financial statements	–	–	–	–	23	29
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in auditee's annual report	–	–	53⋆	57⋆	–	–
2.24a	Consider and report (in audit report) on the impact of auditee on its local community	–	–	–	–	–	–
2.24b	Consider and report (in the audit report) on the impact of auditee on its environment	–	–	–	–	–	–
2.25	Verify every transaction of the auditee	–	–	–	–	–	–
2.26a	Examine and report (in the audit report) on the reliability of information in auditee's entire annual report	–	–	–	48	49	–
2.26b	Examine and report (in the audit report) on information in auditee's annual report which is inconsistent with the financial statements‡	–	–	–	–	–	–
2.27ai	Examine listed company auditees compliance with all the Stock Exchange's governance requirements and report (in audit report) on their compliance	–	–	51⋆	48⋆	–	–
2.27aii	Examine listed company auditees compliance with all the Stock Exchange's governance requirements and report (in audit report) instances of non-compliance	–	N/A	–	N/A	39	N/A
2.27bii	Examine listed company auditees compliance with specified set of Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance†	–	N/A	–	N/A	–	N/A
2.28	Examine and report to auditee's directors (or equivalent) on adequacy of auditee's risk management procedures	–	–	68⋆	63⋆	–	–
2.29	Examine and report (in the audit report) on the adequacy of auditee's risk management procedures	–	–	–	–	45	38
2.30	Examine and report (in attached audit report) on reliability of auditee's financial information on the Internet	–	–	–	–	43	33
No. of responsibilities		7	5	10	14	23	18
Measure of unfulfilled expectations attaching to component		131	94	666	832	794	637
Proportion of expectation-performance gap		8%	6%	42%	53%	50%	41%

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.

[2] Percentage of the society group (non-auditor respondents) who signified that auditors perform the responsibility poorly, or that the responsibility should be performed by auditors, as applicable.

⋆ The difference in the proportion of the society group in the UK and NZ, respectively, who signalled that auditors perform the responsibility poorly, or that auditors should perform the responsibility, as applicable, is not statistically significant.

‡ Duty of auditors in both the UK and NZ considered by society in UK and NZ, respectively, to be performed satisfactorily.

† Duty of auditors in the UK (but not NZ) considered by society in UK to be performed satisfactorily

N/A Not included in the NZ survey instrument

Comparison of the deficient standards gap in the UK and NZ in 1999

While the deficient standards gap in the UK was constituted by ten responsibilities (with 666 units of unfulfilled expectations attached), in NZ it comprised 14 responsibilities (and 832 units of unfulfilled expectations). Nine responsibilities featured in the deficient standards gap in both countries. These were the responsibilities:

- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority if during an audit it is discovered that information in the financial statements has been deliberately distorted, or if suspicious circumstances are encountered suggesting that theft of auditee assets or deliberate distortion of the financial statements may have occurred (2.11d and 2.13);
- to disclose the fact in the audit report if during an audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees, or by the directors or senior management, or that the directors or senior management have committed other illegal acts which directly impact on the financial statements (2.12b, 2.12c and 2.15a);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls, and on the reasonableness of financial forecasts included in its annual report (2.18a and 2.23);
- to report privately to the auditee's directors on the adequacy of procedures for identifying and managing its risk exposures (2.28);
- to examine a listed company auditee's compliance with all of the Stock Exchange's corporate governance requirements and to report (in the audit report) whether or not it has complied with those requirements [2.27a (NZ) and 2.27ai (UK)].

Of the five responsibilities that contributed to the deficient standards gap in NZ, but not in the UK, three are existing responsibilities of auditors in the UK. As noted above, two of these (2.11c and 2.16) are elements of the deficient performance gap in the UK. The third responsibility – 'to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its directors' and senior executives' remuneration policy and record' (2.17d) – does not contribute to the audit expectation-performance gap in the UK as the society group adjudged auditors' performance of this responsibility to be satisfactory. If auditing regulators in NZ followed the example of their UK counterparts and required auditors in NZ to perform these three responsibilities, the research findings suggest that this would result in a reduction of the deficient standards gap in NZ of about 21% (a reduction by 175 units of the 832 units of unfulfilled expectations constituting the deficient standards gap in NZ). It is pertinent to note that if the unfulfilled expectations attaching to these three responsibilities in NZ were eliminated, the total of the remaining unfulfilled expectations comprising the deficient standards gap would be almost the same as that in the UK (657 units in NZ compared to 666 units in the UK).

The other two responsibilities that contributed to the deficient standards gap in NZ, but not in the UK, namely, 'to audit half-yearly published financial statements' (2.22a), and 'to examine and report (in the audit report) on the reliability of information in the auditee's entire annual report' (2.26a), featured as elements of the reasonableness gap in the UK. This finding suggests that, compared with UK society, NZ society perceives greater benefits (and/or lower costs) are likely to result from auditors performing these responsibilities, and it may indicate that NZ society believes auditors should play an enhanced role in securing greater corporate accountability.

The responsibility: 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the DTI in the UK or the Registrar of Companies in NZ) doubts about the continued existence of an auditee (2.5a), contributed to the deficient standards gap in the UK but to the reasonableness gap in NZ. It is suggested that this finding may reflect the fact that, during the 1990s, more major companies collapsed unexpectedly – without any prior warning from their auditors – in the UK than in NZ. As noted above in relation to the deficient performance gap, auditors in both the UK and NZ have an existing responsibility to report doubts about the continued existence of an auditee in the audit report. However, given the absence of warning by the relevant auditors about the impending failure of companies such as the Bank of Credit & Commerce International (BCCI) and Barings Bank, UK society may consider that auditors would be more willing to report doubts about the continued existence of an auditee privately to an appropriate authority than they appear to be to report such doubts publicly in the audit report[4].

Comparison of the reasonableness gap in the UK and NZ in 1999

From Table 9.2 it may be seen that, while 23 responsibilities (and 794 units of unfulfilled expectations) constituted the reasonableness gap in the UK, 18 responsibilities (with 637 units of unfulfilled expectations attached) comprised this gap in NZ. However, despite the difference in the extent of the reasonableness gap in the two countries, their composition is remarkably similar and they have 17 responsibilities in common. These are as follows:

- to guarantee that the audited financial statements are completely accurate, and that an auditee whose financial statements receive an unqualified audit report is financially sound (2.2 and 2.4);
- to report to the Inland Revenue (in the UK, or Inland Revenue Department in NZ) breaches of tax law discovered during an audit (2.7);
- to detect minor theft of auditee assets by non-managerial employees, or by the directors or senior management (2.9a and 2.9b);
- in the absence of a regulated industry duty to do so, to report privately to an appropriate authority (such as the SFO or police) if during an audit it is discovered that minor theft, or theft of a significant amount, of auditee assets has been committed by non-managerial employees (2.11a and 2.11b);
- to disclose the fact in the audit report if during an audit it is discovered that minor theft of auditee assets has been committed by non-managerial employees (2.12a);
- to detect, and to disclose in the audit report, illegal acts by the directors or senior management which indirectly impact on the financial statements (such as breaches of occupational and environmental laws and regulations) (2.14b and 2.15b);
- to examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls, on its computer systems, on the efficiency and effectiveness of its management and administration, on the adequacy of its procedures for identifying and managing its risk exposures, and on the reliability of information contained in its annual report about its occupational health and safety policy and record (2.18b, 2.19, 2.21, 2.29 and 2.17c);
- to audit quarterly published financial statements (2.22b); and
- to examine and report (in an attached audit report) on the reliability of financial information provided by the auditee on the internet (2.30).

The remaining responsibility that contributed to the reasonableness gap in NZ, but not in the UK, is: 'in the absence of a regulated industry duty to do so, to report privately to an appropriate authority doubts about the continued existence of an auditee' (2.5a). As noted above in relation to the deficient standards gap, this responsibility contributed to the reasonableness gap in NZ but to the deficient standards gap in the UK. Similarly, two responsibilities that featured as elements of the reasonableness gap in the UK, contributed to the deficient standards gap in NZ. These are the responsibilities 'to audit half-yearly published financial statements' (2.22a), and 'to examine and report (in the audit report) on the reliability of information in the auditee's entire annual report' (2.26a).

Of the four remaining responsibilities that contributed to the reasonableness gap in the UK, but not in NZ, the responsibility 'to examine a listed company auditee's compliance with the Stock Exchange's corporate governance requirements and to report instances of non-compliance' (2.27aii) did not feature in the NZ survey instrument. As explained in chapter three, this reflects differences in the UK and NZ Stock Exchanges' corporate governance requirements. The other three responsibilities were elements of 'society's expectations of auditors' in the UK but not in NZ[5]. These were the responsibilities:

- to prepare the auditee's financial statements (2.1); and
- to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its equal employment opportunities, and its product safety, policy and record (2.17a and 2.17b).

The inclusion of responsibilities 2.17a and 2.17b within 'society's expectations of auditors' in the UK may reflect the higher profile of corporate governance issues in the UK, compared with NZ. However, particularly in light of the adoption of the 'long form' audit report in both countries (which explicitly notes that the directors are responsible for the preparation of the financial statements), the inclusion of responsibility 2.1 (see above) as an element of 'society's expectations of auditors' in the UK is difficult to explain. It reflects the fact that, although 29% of the society group in each country revealed a 'knowledge gap' in respect of the suggested responsibilities of auditors included in the survey instrument overall, 28% of the society group in the UK, compared with 17% of the society group in NZ, displayed a 'knowledge gap' in relation to responsibility 2.1. Why this difference should exist is a mystery of the research findings.

Summary and key issues

In this chapter the extent and composition of the audit expectation-performance gap, as it was found to exist in NZ in 1999, has been summarised and presented diagrammatically. It has also been compared with the gap that pertained in NZ in 1989, and with the gap that existed in the UK in 1999.

It was noted that in NZ in 1999, the reasonableness gap constituted 41% of the audit expectation-performance gap, and the deficient standards and deficient performance portions of the performance gap, comprised 53% and 6%, respectively. In 1989, the reasonableness gap accounted for 31% of the audit expectation-performance gap, the deficient standards gap 58%, and the deficient performance gap 11%. Thus, over the decade from 1989 to 1999, NZ society perceived auditors' performance to have improved significantly but, at the same time, its expectations of auditors widened markedly – largely in relation to corporate accountability and corporate governance issues. Indeed, over the decade, the narrowing of the audit expectation-performance gap through auditors' improved performance was more than offset by a widening of the reasonableness gap. (In 1989, the audit expectation-performance gap in NZ comprised 1140 units of unfulfilled expectations, compared with 1563 units in 1999 – an increase of 37%).

Comparing the extent of the audit expectation-performance gap in 1999 in the UK and NZ, respectively, it was found to be strikingly similar. (The gap in the UK comprised 1591 units of unfulfilled expectations compared with 1563 units in NZ – a difference of less than 2%.) However, the relative contribution of the components to the overall gap differed markedly. In the UK, the reasonableness gap constituted 50% of the audit expectation-performance gap, the deficient standards gap 42%, and the deficient performance gap 8%. This compares with 41%, 53% and 6%, respectively, for these components of the audit expectation-performance gap in NZ.

Nevertheless, analysis of the responsibilities comprising the respective components of the audit expectation-performance gap in the two countries reveals that they are very similar. The most notable differences are:

(i) three responsibilities contributing to the deficient standards gap in NZ are existing responsibilities in the UK (two of these feature in the deficient performance gap in the UK); and

(ii) three responsibilities contributing to the reasonableness gap in the UK, but not in NZ, reflect the greater attention accorded to corporate governance issues in the UK.

Key findings of the research reported in this chapter include the following:

- The extent of the audit expectation-performance gap in the UK and NZ in 1999 is very similar but exceeds the extent of the gap in NZ in 1989 by about 37%.
- Perceived performance of auditors' responsibilities has improved significantly since 1989 but the resultant narrowing of the audit expectation-performance gap has been more than offset by extended expectations of auditors.
- The constituent responsibilities of the reasonableness, deficient standards and deficient performance gaps in the two countries are strikingly similar.
- The reasonableness gap is wider in the UK than in NZ, largely as a result of UK society's greater expectations of auditors in the corporate governance arena.
- The deficient standards gap is wider in NZ than in the UK, primarily as a consequence of the contribution of three responsibilities to the gap in NZ that are existing responsibilities in the UK. (Two of these contribute to the deficient performance gap in the UK).
- When allowance is made for the two responsibilities that are existing responsibilities in the UK, but not in NZ, which feature in the deficient performance gap in the UK, the deficient performance gaps in the UK and NZ are almost identical in extent and composition.

Endnotes:

1 As noted above in relation to the deficient standards gap, the complementary responsibility – 'to report the fact in the audit report if during an audit it is discovered that theft of a significant amount of auditee assets has been committed by non-managerial employees' (2.12b) contributed to the deficient standards gap in 1999.

2 As noted above, the responsibility: 'to examine and report (in the audit report) on the reliability of information contained in the auditee's annual report about its directors' and senior executives' remuneration policy and record' (2.17d) contributed to the deficient standards gap in 1999. This is another element of the single responsibility (2.27) which was expressed in general terms in the 1989 questionnaire.

3 Derived from the proportion of the society group who signified that auditors perform the relevant responsibilities poorly.

4 It is pertinent to recall that 23% of the UK society group adjudged auditors' performance of their duty to report (in the audit report) doubts about the continued existence of an auditee as poor.

5 It should be recalled from earlier chapters that 'society's expectations of auditors' in the UK and NZ consisted of the responsibilities that were identified by at least 20% of the respective society group as responsibilities auditors should perform.

Chapter Ten

Conclusions and Recommendations

In chapter one it was noted that research investigating the audit expectation-performance gap was conducted in both the UK and NZ in November and December 1999, and that this research replicated Porter's study of the gap in NZ in 1989 (Porter 1993). Conducting the research in both the UK and NZ, and replicating Porter's 1989 NZ study, facilitated achievement of the following objectives:

1. to investigate the structure, composition and extent of the audit expectation-performance gap in the UK and NZ in 1999;
2. to compare the structure, composition and extent of the audit expectation-performance gap in the UK and NZ, respectively, in 1999, and to identify and tentatively explain differences in the gaps (a cross-cultural study); and
3. to compare the structure, composition and extent of the audit expectation-performance gap in the UK and NZ, respectively, in 1999 with that pertaining in NZ in 1989, and to identify and tentatively explain differences in the gaps existing a decade apart (a longitudinal study).

The results of the UK portion of the research have been the primary focus of this report but the findings relating to each of the objectives noted above have also been outlined.

In chapter three it was reported that the research in both the UK and NZ was undertaken by means of a questionnaire that was mailed to randomly selected members of four broad interest groups. These groups, each of which has a distinct and different relationship with auditors and the audit function, are as follows:

- external auditors – performers of external financial statement audits;
- auditees – subjects of external audits;
- audit beneficiaries from the financial community – direct beneficiaries of the audit function (as users of audited financial statements); and
- audit beneficiaries from outside the financial community – indirect beneficiaries of the audit function (for example, as members of pension funds and/or as contributors to National or Local Government funds (via taxes) which are invested in companies that are subject to audit).

It was also noted in chapter three that the survey instrument used for the 1999 research differed from that used for the 1989 NZ study in that it contained 51 suggested responsibilities of auditors, compared with 30 suggested responsibilities in the earlier questionnaire. The additional responsibilities reflect the extension of the domain (principally in the areas of corporate governance and accountability) in which auditors are, or are expected to be, significant players.

As shown in chapters seven and nine, comparison of the 1999 survey findings with those derived from the 1989 study provides some insight into how the structure, composition and extent of the audit expectation-performance gap changed over the decade from 1989 to 1999. It also enables tentative conclusions to be drawn about ways in which the gap might be narrowed. Such conclusions (and related recommendations) are the subject of this chapter.

Importance of narrowing the audit expectation-performance gap

It was explained in the Introduction to this report (Chapter 1) that the audit expectation-performance gap (defined as the gap between what society expects of auditors and what it perceives it receives from them) gives rise to widespread criticism of, and litigation against, auditors. As the recent Enron, WorldCom and Xerox (among other) debacles bear witness, the adverse consequences of auditors failing to fulfil the responsibilities expected of them by individuals or groups in society – or failing to fulfil them to the expected standard – are not limited to the individual auditors and/or audit firms concerned. Instead, they extend widely and result in undermining society's confidence in the audit profession as a whole and in the work that it does.

It follows that in order to reduce – if not eliminate – criticism of, and litigation against, auditors and to restore confidence in the auditing profession and the audit function, the audit expectation-performance gap must be narrowed. Knowledge of the structure and composition of the gap, and how these changed over the decade from 1989 to 1999, provides valuable insight into how this may be achieved.

Narrowing the 'performance gap' component of the audit expectation-performance gap

In chapters seven and nine it was noted that the performance gap component of the audit expectation-performance gap narrowed significantly over the decade from 1989 to 1999. Further, both the deficient performance and deficient standards portions of the performance gap were reduced: in 1989 in NZ, the deficient performance portion constituted 11% of the audit expectation-performance gap and the deficient standards portion, another 59%. In 1999 in NZ and the UK, respectively, the comparative proportions were 6% and 8% for the deficient performance gap, and 53% and 42% for the deficient standards gap. Thus, the contribution of the performance gap to the audit expectation-performance gap overall fell from 69% in NZ in 1989 to 59% in NZ, and 50% in the UK, in 1999.

The reduction in the performance gap between 1989 and 1999 can largely be attributed to the improvement in the quality control of auditors' work by the professional bodies[1], and the development of revised and new auditing standards.

Quality control of auditors' work by the professional bodies

Since 1989, monitoring of auditors' work by the professional bodies' monitoring units has been introduced in both NZ and the UK and it is suggested that this is responsible, in no small measure, for the apparent improvement in auditors' performance. This conclusion accords with the opinions of the monitoring units in both the UK and NZ – as reflected in their annual reports to the Department of Trade and Industry (DTI) in the UK and to the Council of the Institute of Chartered Accountants of New Zealand (ICANZ) in NZ (see Porter 1995).

In both countries, the monitoring units emphasise that the key objective of their monitoring activities is education. Through their visits to audit firms, monitoring unit staff are able to draw attention to practices that need improvement and to new or revised auditing standards and/or other requirements that may have escaped the notice of the auditing practitioners concerned. Further, in cases where sanctions for sub-standard performance are appropriate, formal education requirements may be imposed. Additionally, or alternatively, where poor performance is found, other sanctions may be imposed. For example, audit practitioners or firms may be precluded from accepting new clients or (in the case of individuals) from acting as audit engagement partners. In extreme cases of poor performance (combined with little indication of an intention or ability to improve) the practitioners or firms concerned may be prohibited from performing audits. With the correction of sub-standard performance and the removal of seriously poor performers, the performance of auditors as a whole, as perceived by society, may be expected to improve. (For a full discussion of monitoring auditors in the UK and NZ see Porter, 1995).

Development of revised or new auditing standards

Since 1989 a revised 'Going concern' auditing standard has been issued in both the UK and NZ (SAS 130: *Going Concern,* in the UK in 1994, and AS 520: *Going Concern,* in NZ in 1998). These standards provide much clearer and more stringent guidance to auditors than did their predecessors on what is required of them as regards assessing the going concern status of the auditee and reporting doubts about its continued existence. The impact of the revised standards on auditors' performance of the responsibility 'to disclose in the audit report doubts about the continued existence of the auditee' (2.5b – the responsibility that constituted 30% of the deficient performance gap in NZ in 1989: see Figure 7.2) is reflected in the fact that, while 37% of the society group in NZ in 1989 adjudged auditors' performance of this responsibility to be poor, in 1999 only 23% and 20% of the UK and NZ society group, respectively, signified this opinion.

Also since 1989 in the UK, revised auditing standards SAS 110: *Fraud and Error* and SAS 120: *Consideration of law and regulations* (both issued in January 1995) introduced a provision whereby auditors are required, when it is in the public interest to do so, to report matters of concern encountered during an audit (such as fraud or other illegal acts by the senior officers of a significant company) to a proper authority. Thus, while in NZ in 1989, and indeed also in 1999, the suggested responsibilities: 'in the absence of a regulated industry requirement to do so, to report privately to an appropriate authority (such as the Serious Fraud Office, police or DTI) if during an audit it is discovered that the auditee's directors or senior management have embezzled organisational assets or committed other illegal acts' (2.11c and 2.16), were not among auditors' existing responsibilities, they were in the UK in 1999.

In NZ in 1989, 74% and 64%, respectively, of the society group indicated that auditors should be required to perform responsibilities 2.11c and 2.16 (see above). As these responsibilities met the cost-benefit criterion, but were not existing responsibilities of auditors, they contributed to the deficient standards gap (see Figure 7.2). A decade later, in 1999, the proportion of the NZ society group indicating the same opinion about these responsibilities was 70% and 58%, respectively (see Figure 9.1) – a difference that is not statistically significant. However, in the UK, as a consequence of revised auditing standards SAS 110 and SAS 120, these responsibilities were existing responsibilities of auditors and they comprised elements of the deficient performance gap. Nevertheless, just 17% and 13%, respectively, of the society group signified that auditors perform responsibilities 2.11c and 2.26 (see above) poorly.

Recommendations for narrowing the performance gap

Following on from the observations set out above, it is recommended that the following measures be adopted as means of further narrowing the performance gap.

1. *Continued, and strengthened, monitoring of auditors' performance*

Given the apparent success of monitoring of auditors' performance in effecting improved performance, it is recommended that this activity be continued and strengthened through insistence on even better performance (for example, through less leniency being granted in cases where auditing or other professional standards are found not to have been followed properly and completely) and more stringent sanctions being imposed when instances of sub-standard performance are encountered.

2. *Improving quality controls in audit firms*

Although monitoring of auditors' performance has brought benefits in terms of improved performance, in order to ensure that all auditors (be they partners, managers, or other audit team members) perform their work to the required standard on every audit, monitoring activities need to be supplemented by effective quality control systems within audit firms. The Auditing Practices Board (APB) in the UK has taken an important step in this regard. In September 2000 it issued a revised Statement of Auditing Standards (SAS) 240: *Quality control for audit work.* This provides clear and exacting guidance on the quality control policy and processes audit firms are to implement. According to SAS 240, its quality control requirements are designed to provide reasonable assurance as to the appropriateness of the auditors' report and of adherence to Auditing Standards, ethical and other regulatory requirements. (para 2)

A revised International Auditing Standard (ISA) 220: *Quality control for audit engagements*, which closely follows the UK's SAS 240, is in the course of development. Once finalised, this standard will be incorporated, in all its essential requirements, in New Zealand's auditing standards[2].

3. Enhanced education

As noted above, education of auditing practitioners is a key objective of the monitoring process. However, the research findings suggest that further education of auditors is required. In chapters four and eight it was reported that auditors have a 'knowledge gap' with respect to their existing responsibilities: about 18% of auditors in the UK and 20% in NZ appear to be uncertain or in error about their existing responsibilities (see Appendices C and D). It is therefore recommended that further education (possibly through compulsory professional development sessions) be required of all existing (as well as trainee) auditors about their responsibilities under statute and case law, *quasi*-governmental regulations and professional promulgations, and also about the standard of work that is required.

The research results suggest that, although auditors' performance (or, more pertinently, society's perceptions thereof) improved quite markedly over the decade from 1989 to 1999, dissatisfaction with the standard of performance of their responsibilities remains – dissatisfaction that has been exacerbated as a result of the recent Enron, WorldCom, Xerox and other well-publicised debacles. Society's adverse perceptions may, of course, be distorted, but irrespective of whether they are soundly based, they endanger the reputation of – and confidence in – the auditing profession. The standard of performance of auditors' responsibilities (and society's perceptions thereof) will not change overnight. However, more rigorous monitoring of auditors' performance, improved quality controls within audit firms, and enhanced education for all auditors should, in time, result in improved actual and perceived performance by auditors – and thus in a further narrowing of the deficient performance portion of the performance gap.

4. New auditing standards

In order to narrow the deficient standards portion of the performance gap, auditing standards need to be extended to embrace the responsibilities that are cost-effective for auditors to perform. Most of the responsibilities identified by the research as reasonably expected, but not required, of auditors (*ie*. those comprising the deficient standards gap), have featured prominently in recent corporate governance or other similar debates. In the UK in 1999, under the Stock Exchange's Listing Rules, auditors of listed companies were required to review their auditees' compliance with seven provisions of the Combined Code and to report instances of non-compliance[3] (see Appendix B). Thus, at the time of the research in the UK, the suggested responsibility 'to review listed company auditees' compliance with a specified set of the Stock Exchange's corporate governance requirements and to report instances of non-compliance' (2.27bii) was an existing responsibility of auditors. The UK society group adjudged auditors' performance of this responsibility to be satisfactory and thus it does not feature as an element of the audit expectation-performance gap. Nevertheless, 51% and 48% of the UK and NZ society groups, respectively, signified that they expect auditors to perform a broader responsibility than that outlined above: they expect auditors to examine listed company auditees' compliance with all (rather than a limited set) of the Stock Exchange's corporate governance requirements and to report whether or not those requirements have been complied with (rather than merely reporting instances of non-compliance) (responsibility 2.27ai in the UK and 2.27a in NZ: see Figures 7.1 and 9.1). As implied above, this is not an existing responsibility of auditors and it contributes to the deficient standards portion of the performance gap.

If the auditing profession in the UK and NZ were willing to take the initiative and broaden its responsibilities (through new and/or revised auditing standards) so that auditors' responsibilities were better aligned with society's expectations – where those expectations are reasonable to expect of auditors – the deficient standards gap would be narrowed significantly (see Figures 7.1 and 9.1). However, the willingness of the auditing profession to accept extended responsibilities seems to rest, at least in part, in its ability to see beyond perceived potential increases in exposure to legal liability to the potential benefits to be gained by better meeting society's expectations and thereby enhancing the value of audit function in society.

Narrowing the 'reasonableness gap' component of the audit expectation-performance gap

Unlike the performance gap component of the audit expectation-performance gap, the reasonableness gap component widened significantly over the decade from 1989 to 1999. In 1989 in NZ, this component constituted 31% of the audit expectation-performance gap; in 1999 in NZ it comprised 41%, and in the UK 50%. The expansion of society's expectations of auditors is largely attributable to the spate of unexpected corporate failures since 1989 (including the unheralded demise of some very large companies such as Barings Bank and BCCI in the UK, and Equiticorp in NZ) and revelations of fraud and other misdeeds by the directors and/or other senior executives of these companies which have come to light through investigations of their failure.

Reacting to these events, in both the UK and NZ the Government, regulators and society in general have demanded that public companies be made more accountable for their activities and that they implement measures to ensure responsible corporate governance. Auditors have been identified as key players in the corporate accountability and corporate governance arenas and society has developed expectations of them performing wide-ranging responsibilities in these domains. It is pertinent to note that, although the total level of unfulfilled expectations constituting the audit expectation-performance gap in the UK and NZ are similar (1591 units in the UK and 1563 units in NZ – a difference of less than 2%), the reasonableness gap is significantly wider in the UK than in NZ: it comprises 794 units of unfulfilled expectations in the UK compared with 637 units in NZ – a difference of nearly 25% (see Figures 7.1 and 9.1). It is suggested that this difference results from, and reflects, the greater impact of unexpected corporate failures, and revelations of misdeeds by senior officials of the companies concerned, since 1989 in the UK compared with NZ, and UK society's consequential wider expectations of auditors playing a role in securing enhanced corporate accountability and responsible corporate governance.

Information technology is another key development that has impacted on the reasonableness gap since 1989. Two responsibilities featuring as elements of the reasonableness gap (namely, examining and reporting on the auditee's IT systems, and on the reliability of financial information provided by the auditee on the internet (2.19 and 2.30) relate to this factor.

Notwithstanding the wide range of responsibilities that constitute the reasonableness gap in both the UK and NZ, it should be remembered that these responsibilities do not meet the cost-benefit criterion and, therefore, are not reasonably expected of auditors. It could be that, in time, particularly as corporate governance measures and information technology become more established, that the perceived benefits attaching to auditors performing some of the reasonableness gap duties will increase and/or the costs of them doing so will decrease, such that the responsibilities will become cost-effective for auditors to perform. However, in the meantime, society needs to be better educated about the audit function and what auditors can – and cannot – be reasonably expected to achieve.

Recommendations for narrowing the reasonableness gap

The need for society to be better educated about the audit function and what auditors can reasonably be expected to achieve is particularly well illustrated by the following findings of the research:

- 37% and 38% of the society group in the UK and NZ, respectively, expect auditors to guarantee that audited financial statements are completely accurate;

- 45% and 42% of the society group in the UK and NZ, respectively, expect auditors to guarantee that an auditee whose financial statements receive a unqualified audit report is financially sound;
- 26% of the society group in the UK expect auditors to prepare the auditee's financial statements;
- 52% and 59% of the society group in the UK and NZ, respectively, are unsure or in error about auditors' existing responsibilities (*ie*. they exhibit a 'knowledge gap' in respect of auditors' existing responsibilities: see Appendices C and D).

Although it is evident that society in general in both the UK and NZ needs educating about the audit function and what auditors can reasonably be expected to achieve, it is not easy to identify the means by which this can be accomplished. This is especially the case given that the long-form audit report (which might be expected to function as an effective education medium, at least for financial statement users) clearly specifies that the auditee's directors are responsible for preparing the financial statements and that the auditor's report provides reasonable assurance (not a guarantee!) about the truth and fairness of the audited financial statements and the absence of material misstatements therein. Yet, as noted above, the society group in both the UK and NZ does not appear to have understood (if they have read) the messages contained in the auditor's report. It is of particular concern that 33% and 43% of the financial community group[4] in the UK and NZ, respectively, signified that they expect auditors to guarantee that audited financial statements are completely accurate, and 43% of this group in both the UK and NZ indicated that they expect them to guarantee that an auditee which receives an unqualified audit report is financially sound. Similarly, 41% of the financial community group in the UK signalled that they expect auditors to prepare the auditee's financial statements.

It is suggested that one possible means of educating society at large is to use the opportunity afforded by an infamous fraud and/or unexpected corporate failure (or similar event) which reaches the media headlines to explain the audit function and the work of auditors. At present, when untoward company events occur, it seems that journalists or others seeking to lay the blame at someone's door raise uninformed questions (or allegations) about the relevant auditors' apparent failure to fulfil what the journalists or others presume to be their duties. The question is raised, "where were the auditors?" – indicating that expectations of auditors have not been fulfilled. Even if the auditors had performed their existing responsibilities to the highest standard, the unfulfilled expectations of members of society will serve to fuel criticism of auditors and (further) reduce confidence in their work. When such events occur, the profession's usual response appears to be a formal (and rather technical) statement by a senior representative rebuffing the allegations. Such a statement does little to correct society's misconceptions about the audit function or to restore confidence in the profession. Such occasions could be used to explain, in non-technical, easily understandable and interesting (attention grabbing!) language, the auditors' role in the particular circumstances – also placing those circumstances in the broader context of the audit function and the role and responsibilities of auditors in general.

An alternative, and perhaps more effective way to educate society at large, is to seek opportunities to educate influential journalists, formally and informally, about the audit function and the work of auditors. If they gain some understanding of the work of the profession, they may report adverse events affecting auditors (directly or indirectly) in a more informed and less sensational manner.

The research findings indicate that, in both the UK and NZ, the reasonableness gap is the most extensive and most rapidly expanding component of the audit expectation-performance gap. It seems to follow that the auditing profession in both countries will make greatest progress in narrowing the audit expectation-performance gap (or preventing its further widening) if it concentrates its efforts on educating society (and journalists in particular) about the audit function and the role and responsibilities of auditors.

Conclusion: Auditors' role in narrowing the audit expectation-performance gap

In order to tackle effectively the liability and credibility crises they face, auditors must reduce society's unfulfilled expectations of them – they must narrow the audit expectation-performance gap. As noted in chapter two, according to Limperg (1933, reproduced in Limperg Instituut 1985), the auditor has a dual responsibility: not to arouse 'in the sensible layman' greater expectations than can be fulfilled by the work done, and to carry out the work in a manner that does not betray the expectations evoked. Limperg's analysis underscores the fact that, if auditors fail to identify society's expectations of them and the extent to which they meet (or, more pertinently, fail to meet) those expectations, then not only will they be subject to criticism and litigation but also, if the failure persists, society's confidence in the audit function will be undermined – and, thus, the audit function (and the auditing profession) will be perceived to have no value.

The findings reported in this research report provide some insight into society's expectations of auditors, the perceived standard of their work, and the extent to which those expectations are not being fulfilled. Some recommendations are also proposed on ways in which auditors might better satisfy society's reasonable expectations of them and alter those that are not reasonable. Thus the research contributes in a meaningful way towards narrowing the audit expectation-performance gap. Once auditors' performance (as perceived by society) is better aligned with society's expectations of them, the liability and credibility crises facing auditors should abate and confidence in the auditing profession and the work that it does, should gradually be restored.

Endnotes:

1 More correctly in the UK, the Recognised Supervisory Bodies who have responsibility for, *inter alia,* the standard of work of auditors registered with them.

2 As a matter of policy, in the absence of special circumstances (which do not apply in respect of the quality control standard) ICANZ adopts International Auditing Standards with only minor modification.

3 Auditors are not required to report instances of non-compliance if the auditee has adequately disclosed its non-compliance in its 'statement of compliance'.

4 The group that might be expected to use financial statements are read the auditor's report thereon.

APPENDIX A

QUESTIONNAIRE USED TO INVESTIGATE THE AUDIT EXPECTATION-PERFORMANCE GAP IN THE UNITED KINGDOM

PART 1: PERSONAL DETAILS

1.1 INTEREST GROUP

Please circle the relevant number for **all** of the groups to which you belong, **or** to which you have belonged in the past three (3) years.

	Now	Not now but in past 3 years		Now	Not now but in past 3 years
Audit partner	1	2	Audit staff	1	2
Executive Director	1	2	Non-Executive Director	1	2
Senior non-director company manager	1	2	Senior accountant/ Financial controller/ Director	1	2
Audit Committee member	1	2	Internal Auditor	1	2
Stockbroker or Financial Analyst	1	2	Private debenture holder/ Corporate bond holder	1	2
Banker – without corporate lending responsibilities	1	2	Banker – with corporate lending responsibilities	1	2
Employed by a Local Authority	1	2	Employed by a public sector organisation other than a Local Authority	1	2
Private shareholder	1	2	Institutional investor	1	2
Member of an Employees' Union (*eg.* Trade Union or similar)	1	2	Employed by the Inland Revenue	1	2
Member of Parliament	1	2	Lawyer	1	2
Financial journalist	1	2	Teacher of auditing in a tertiary institution	1	2
Employed by the Department of Trade and Industry, or the Stock Exchange	1	2	Expert witness in auditing	1	2
Involved in regulating *auditing* or monitoring audit quality	1	2	Involved in regulating *accounting* or external financial reporting	1	2
Member of a professional accounting body	1	2	Employed by a public sector audit agency	1	2

For Questions 1.2 and 1.3 please note the following definitions which distinguish between "read" and "glance at": "***Read***" means to look at the financial statements or auditor's report in some detail. "***Glance at***" means a brief scan of the financial statements or auditor's report.					
1.2	**INTEREST IN FINANCIAL STATEMENTS:**				
	(a) If you obtain an organisation's financial statements, you ***glance at*** the financial statements				
	Never	**Rarely**	**Occasionally**	**Usually**	**I do not obtain financial statements**
	1	**2**	**3**	**4**	**0**
	(b) If you obtain an organisation's financial statements, you ***read*** the financial statements:				
	Never	**Rarely**	**Occasionally**	**Usually**	**I do not obtain financial statements**
	1	**2**	**3**	**4**	**0**
1.3	**INTEREST IN THE AUDITOR'S REPORT:**				
	(a) When you glance at or read organisations' financial statements you ***glance at*** the auditor's report:				
	Never	**Rarely**	**Occasionally**	**Usually**	**I do not obtain financial statements**
	1	**2**	**3**	**4**	**0**
	(b) When you glance at or read organisations' financial statements you ***read*** the auditor's report:				
	Never	**Rarely**	**Occasionally**	**Usually**	**I do not obtain financial statements**
	1	**2**	**3**	**4**	**0**

PART 2: THE RESPONSIBILITIESOF AUDITORS	
Please complete BOTH sections 1 and 2	
Part 2 – Section 1a: **Please complete section 1a** by circling the appropriate number to indicate whether ***you think*** the listed responsibility IS or IS NOT AN EXISTING RESPONSIBILITY of auditors, or whether you are not sure. **Part 2 – Section 1b: IF you circled '1' in section 1a** please complete section 1b by circling the appropriate number to indicate how well you think auditors perform the responsibility. **Part 2 – Section 2: Please complete section 2** by circling the appropriate number to indicate whether ***you think*** the listed responsibility SHOULD or SHOULD NOT BE performed by auditors, or whether you are not sure.	
Responsibilities of auditors are:	
2.1	To **prepare** the organisation's financial statements
2.2	To **guarantee** that the audited financial statements are **completely** accurate
2.3	To **state** whether or not the financial statements **fairly reflect** the organisation's financial affairs
2.4	To **guarantee** that an organisation whose financial statements have been given an unqualified ("clean") audit report is financially sound
2.5	Where the auditor has **doubts** about the **continued existence** of the organisation under audit, **to express such doubts**:
	(a) **Privately** to an appropriate authority, such as the Department of Trade and Industry or the Financial Services Authority
	(b) In the published **auditor's report** (*ie*. the report which is attached to the organisation's published financial statements)
2.6	To ensure that the requirements of the Companies Acts or other relevant legislation have been complied with.
2.7	To **report** to the Inland Revenue **breaches of tax law** discovered during an audit
2.8	To **detect** theft of a significant amount (such as 5% or more of the organisation's turnover or total assets) which has been committed by the organisation's:
	(a) non-managerial employees
	(b) directors or senior management
2.9	To **detect** minor theft (other than petty theft) which has been committed by the organisation's:
	(a) non-managerial employees
	(b) directors or senior management
2.10	To detect deliberate distortion of the figures (or other information) presented in the organisation's financial statements
2.11	In the absence of a duty under regulated industry requirements, to report privately to an appropriate authority such as the Serious Fraud Office, Police or Department of Trade and Industry, if during the audit it is discovered that:
	(a) minor theft (other than petty theft) has been committed by non-managerial employees
	(b) theft of a significant amount has been committed by non-managerial employees
	(c) the organisation's directors or senior management have embezzled organisational assets
	(d) information presented in the financial statements has been deliberately distorted

SECTION 1a Please complete this section It is an EXISTING RESPONSIBILITY of auditors				SECTION 1b Please answer this section if you circled "1" in section 1a HOW WELL is the existing Responsibility performed?				SECTION 2 Please complete this section Auditors SHOULD perform this responsibility		
	Yes	No	Not sure	Poorly	Adequately	Well	Unable to judge	Yes	No	Not sure
2.1	1	2	3	1	2	3	4	1	2	3
2.2	1	2	3	1	2	3	4	1	2	3
2.3	1	2	3	1	2	3	4	1	2	3
2.4	1	2	3	1	2	3	4	1	2	3
2.5(a)	1	2	3	1	2	3	4	1	2	3
2.5(b)	1	2	3	1	2	3	4	1	2	3
2.6	1	2	3	1	2	3	4	1	2	3
2.7	1	2	3	1	2	3	4	1	2	3
2.8(a)	1	2	3	1	2	3	4	1	2	3
2.8(b)	1	2	3	1	2	3	4	1	2	3
2.9(a)	1	2	3	1	2	3	4	1	2	3
2.9(b)	1	2	3	1	2	3	4	1	2	3
2.10	1	2	3	1	2	3	4	1	2	3
2.11(a)	1	2	3	1	2	3	4	1	2	3
2.11(b)	1	2	3	1	2	3	4	1	2	3
2.11(c)	1	2	3	1	2	3	4	1	2	3
2.11(d)	1	2	3	1	2	3	4	1	2	3

PART 2: THE RESPONSIBILITIESOF AUDITORS (continued)	
2.12	To disclose the fact in the published auditor's report if during the audit it is discovered that:
	(a) minor theft (other than petty theft) has been committed by non-managerial employees
	(b) theft of a significant amount has been committed by non-managerial employees
	(c) the organisation's directors or senior management have embezzled organisational assets
	(d) information presented in the financial statements has been deliberately distorted
2.13	In the absence of a duty under regulated industry requirements, to report privately to an appropriate authority, such as the Serious Fraud Office, Police or Department of Trade and Industry, if during the audit suspicious circumstances are encountered, suggesting that theft or deliberate distortion of the financial information may have occurred
2.14	To detect illegal acts committed by the organisation's management or directors:
	(a) which directly impact on the company's financial statements (such as bribery and political payoffs)
	(b) which only indirectly impact on the organisation's financial statements (such as breaches of occupational safety and environmental laws and regulations)
2.15	To disclose in the published auditor's report illegal acts committed by the organisation's management or directors which are discovered during the audit:
	(a) which directly impact on the organisation's financial statements (such as bribery and political payoffs)
	(b) which only indirectly impact on the organisation's financial statements (such as breaches of occupational safety and environmental laws and regulations)
2.16	In the absence of a duty under regulated industry requirements, to report privately to an appropriate authority, such as the Police or Department of Trade and Industry, if during an audit it is discovered that illegal acts have been committed by the organisation's management or directors
2.17	To examine and report (in the published auditor's report) on the fairness (reliability) of information contained in the organisation's annual report about the organisation's:
	(a) equal employment opportunities policy and record
	(b) product safety policy and record
	(c) occupational health and safety policy and record
	(d) directors' and senior executives' remuneration policy and record

SECTION 1a Please complete this section It is an EXISTING RESPONSIBILITY of auditors				SECTION 1b Please answer this section if you circled "1" in section 1a HOW WELL is the existing Responsibility performed?				SECTION 2 Please complete this section Auditors SHOULD perform this responsibility		
	Yes	No	Not sure	Poorly	Adequately	Well	Unable to judge	Yes	No	Not sure
2.12(a)	1	2	3	1	2	3	4	1	2	3
2.12(b)	1	2	3	1	2	3	4	1	2	3
2.12(c)	1	2	3	1	2	3	4	1	2	3
2.12(d)	1	2	3	1	2	3	4	1	2	3
2.13	1	2	3	1	2	3	4	1	2	3
2.14(a)	1	2	3	1	2	3	4	1	2	3
2.14(b)	1	2	3	1	2	3	4	1	2	3
2.15(a)	1	2	3	1	2	3	4	1	2	3
2.15(b)	1	2	3	1	2	3	4	1	2	3
2.16	1	2	3	1	2	3	4	1	2	3
2.17(a)	1	2	3	1	2	3	4	1	2	3
2.17(b)	1	2	3	1	2	3	4	1	2	3
2.17(c)	1	2	3	1	2	3	4	1	2	3
2.17(d)	1	2	3	1	2	3	4	1	2	3

PART 2: THE RESPONSIBILITIESOF AUDITORS (continued)	
2.18	To examine and report (in the published auditor's report) on the effectiveness of the organisation's:
	(a) internal financial controls
	(b) internal non-financial controls
2.19	To examine and report (in the published auditor's report) on the effectiveness of the organisation's computer systems
2.20	To examine and report (in the published auditor's report) on the organisation's non-financial performance
2.21	To examine and report (in the published auditor's report) on the efficiency and effectiveness of the organisation's management and administration
2.22	(a) To audit half-yearly published financial statements
	(b) To audit quarterly published financial statements
2.23	To examine and report (in the published auditor's report) on the fairness (reasonableness) of financial forecasts included in the organisation's annual report
2.24	To consider and report (in the published auditor's report) on the impact (good and bad) of the organisation on:
	(a) its local community
	(b) its environment
2.25	To examine evidence to verify every transaction entered into by the organisation
2.26	To examine the organisation's entire annual report (the report containing or accompanying its financial statements) and report in the published auditor's report:
	(a) on the fairness (reliability) of the information contained in the annual report as a whole
	(b) only on information within the annual report which is inconsistent with the financial statements

SECTION 1a Please complete this section It is an EXISTING RESPONSIBILITY of auditors				SECTION 1b Please answer this section if you circled "1" in section 1a HOW WELL is the existing Responsibility performed?				SECTION 2 Please complete this section Auditors SHOULD perform this responsibility		
	Yes	**No**	**Not sure**	**Poorly**	**Adequately**	**Well**	**Unable to judge**	**Yes**	**No**	**Not sure**
2.18(a)	1	2	3	1	2	3	4	1	2	3
2.18(b)	1	2	3	1	2	3	4	1	2	3
2.19	1	2	3	1	2	3	4	1	2	3
2.20	1	2	3	1	2	3	4	1	2	3
2.21	1	2	3	1	2	3	4	1	2	3
2.22(a)	1	2	3	1	2	3	4	1	2	3
2.22(b)	1	2	3	1	2	3	4	1	2	3
2.23	1	2	3	1	2	3	4	1	2	3
2.24(a)	1	2	3	1	2	3	4	1	2	3
2.24(b)	1	2	3	1	2	3	4	1	2	3
2.25	1	2	3	1	2	3	4	1	2	3
2.26(a)	1	2	3	1	2	3	4	1	2	3
2.26(b)	1	2	3	1	2	3	4	1	2	3

PART 2: THE RESPONSIBILITIESOF AUDITORS (continued)	
2.27	In the case of a listed company:
	(a) to examine its compliance with all of the Stock Exchange's corporate governance requirements and to report (in the published auditor's report):
	(i) whether or not it has complied with those requirements
	(ii) only instances of non-compliance
	(b) to examine its compliance with a limited (specified) set of the Stock Exchange's corporate governance requirements and to report (in the published auditor's report):
	(i) whether or not it has complied with those requirements
	(ii) only instances of non-compliance
2.28	To examine and report privately to the organisation's directors (or equivalent) on the adequacy of procedures for identifying and managing the organisation's risk exposures
2.29	To examine and report publicly (in the published auditor's report) on the adequacy of procedures for identifying and managing the organisation's risk exposures
2.30	To examine and report (in an attached auditor's report) on the fairness (reliability) of financial information provided by the organisation on the Internet

Please add any further comments you consider relevant regarding:

2.31 The present responsibilities of auditors and how they are performed

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SECTION 1a Please complete this section It is an EXISTING RESPONSIBILITY of auditors				SECTION 1b Please answer this section if you circled "1" in section 1a HOW WELL is the existing Responsibility performed?				SECTION 2 Please complete this section Auditors SHOULD perform this responsibility		
	Yes	No	Not sure	Poorly	Adequately	Well	Unable to judge	Yes	No	Not sure
2.27(a)(i)	1	2	3	1	2	3	4	1	2	3
2.27(a)(ii)	1	2	3	1	2	3	4	1	2	3
2.27(b)(i)	1	2	3	1	2	3	4	1	2	3
2.27(b)(ii)	1	2	3	1	2	3	4	1	2	3
2.28	1	2	3	1	2	3	4	1	2	3
2.29	1	2	3	1	2	3	4	1	2	3
2.30	1	2	3	1	2	3	4	1	2	3

Please add any further comments you consider relevant regarding:

2.32 The responsibilities which auditors should, but currently do not, perform

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Appendix B:

Authority for classifying thirteen of the suggested responsibilities as existing responsibilities of auditors in the United Kingdom in 1999[1]

Resp No.	Suggested responsibilities of auditors	Authority for recognition as an existing responsibility
2.3	To state whether or not the financial statements fairly reflect the organisation's financial affairs	**Companies Act 1985, s.235(2):** 'The auditors' report shall state whether in the auditors' opinion the annual accounts [give] a true and fair view … of the state of affairs of the company as at the end of the financial year [and] … the profit or loss of the company for the financial year'.
2.5b	Where the auditor has doubts about the continued existence of the organisation under audit, to express such doubts in the published auditor's report (i.e. the report which is attached to the organisation's published financial statements	**SAS[2] 130.6:** 'Where the auditors consider that there is a significant level of concern about the entity's ability to continue as a going concern, but do not disagree with the preparation of the financial statements on the going concern basis, they should include an explanatory paragraph when setting out the basis for their opinion' [in the audit report]. **ISA[3] 570 para 15-17:** 'If, in the auditor's judgement, the going concern question is not satisfactorily resolved, the auditor would consider whether the financial statements [provide adequate disclosure]. … If adequate disclosure is made in the financial statements, the auditor should ordinarily express an unqualified opinion and modify the auditor's report by adding an emphasis of a matter paragraph ... If adequate disclosure is not made in the financial statements, the auditor should express a qualified or adverse opinion, as appropriate'.
2.6	To ensure that the requirements of the Companies Acts or other relevant legislation have been complied with	**Companies Act 1985, s.235(2):** 'The auditors' report shall state whether in the auditors' opinion the annual accounts have been properly prepared in accordance with this Act' Also see: **SAS 120.3, 4, 5** and **IAS 31 para 13, 15, 18** below.
2.8a 2.8b	To detect theft of a significant amount (such as 5% or more of the organisation's turnover or total assets) which has been committed by the organisation's non-managerial employees To detect theft of a significant amount (such as 5% or more of the organisation's turnover or total assets) which has been committed by the organisation's directors or senior management	**SAS 110.3:** 'Based on their risk assessment, the auditors should design audit procedures so as to have a reasonable expectation of detecting misstatements arising from fraud or error which are material to the financial statements'. **ISA 240 para 9:** 'Based on the risk assessment the auditor should design audit procedures to obtain reasonable assurance that misstatements arising from fraud and error that are material to the financial statements taken as a whole are detected'. **Case law:** 'An auditor is not bound to be a detective or … to approach his work with suspicion or with a foregone conclusion there is something wrong. He is a watchdog not a bloodhound. [However], if there is anything to excite suspicion he should probe it to the bottom' (Lopes, L.J. In re Kingston Cotton Mill Co Ltd (no 2) [1896] 2 Ch.279]. **SAS 100 para 11:** 'Auditors recognise the possibility that material misstatement may exist and plan and perform the audit with that possibility in mind. This involves examining critically and with professional scepticism the information and explanations provided and not assuming that they are correct'.

2.8a 2.8b (Cont)		**ISA 200 para 6:** 'The auditor should plan and perform the audit with an attitude of professional scepticism recognizing that circumstances may exist which may cause the financial statements to be materially misstated …'. **Companies Act 1985 s.237(1):** 'A company's auditors shall, in preparing their report, carry out such investigations as will enable them to form an opinion as to (a) whether proper accounting records have been kept …'. If theft of a material amount (5% of turnover or total assets) has been committed by the auditee's non-managerial employees or directors/ senior management, unless the theft has been carefully concealed, the auditor (adopting a sceptical attitude) should encounter evidence that 'excites suspicion' – possibly through carrying out the investigations required by Companies Act s.237 (1)(a). (S)he should then 'probe the matter to the bottom'.
2.10	To detect deliberate distortion of the figures (or other information) presented in the organisation's financial statements	**Companies Act 1985 s.235 (2); s.237(1)(a):** see above. **SAS 110.3**: see above. If the financial statements have been deliberately distorted, unless carefully and cleverly concealed, such distortion should be detected by auditors who plan and conduct their audits in accordance with SAS 100.3 and/or the investigations required under Companies Act s.237(1)(a).
2.11c	In the absence of a duty under regulated industry requirements, to report privately to an appropriate authority such as the Serious Fraud Office, Police or Department of Trade and Industry, if during the audit it is discovered that the organisation's directors or senior management have embezzled organisational assets	**SAS.110 10, 12:** 'Where the auditors become aware of a suspected or actual instance of fraud they should (a) consider whether the matter may be one that ought to be reported to a proper authority in the public interest; and where this is the case (b) except in the circumstances covered in SAS 110.12, discuss the matter with the board of directors, including any audit committee. … When a suspected or actual instance of fraud casts doubt on the integrity of the directors auditors should make a report direct to a proper authority in the public interest without delay and without informing the directors in advance'. It is submitted that embezzlement of the organisation's assets by its directors and/or senior management is a matter that 'ought to be reported to a proper authority in the public interest'.
2.12d	To disclose the fact in the published auditor's report if during the audit it is discovered that information presented in the financial statements has been deliberately distorted	**Companies Act 1985 s. 235(2):** (see above) **Companies Act 1985 s. 237(2), (3):** 'If auditors are of opinion that proper accounting records have not been kept … [or] if the auditors fail to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report'. If the auditee's financial statements have been deliberately distorted it seems highly likely that they will not give a 'true and fair view' and/or that proper accounting records will not have been kept and/or that information and explanations required by the auditor will not have been obtained.
2.14a	To detect illegal acts committed by the organisation's management or directors which directly impact on the organisation's financial statements (such as bribery and political payoffs)	**SAS 120.3, 4, 5:** 'The auditors should perform procedures to help identify possible or actual instances of non-compliance with those laws and regulations which provide a legal framework within which the entity conducts its business and which are central to the entity's ability to conduct its business and hence to its financial statements … When carrying out their procedures for the purpose of forming an opinion on the financial statements, the auditors should in addition be alert for instances of possible or actual non-compliance with law or regulations which might affect the financial statements ... .

2.14a (Cont)		… When auditors become aware of information which indicates that non-compliance with law or regulations may exist, they should obtain an understanding of the nature of the act and the circumstances in which it has occurred and sufficient other information to evaluate the possible effect on the financial statements'. **ISA 250 para 13, 15, 18:** '… the auditor should plan and perform the audit with an attitude of professional scepticism recognizing that the audit may reveal conditions or events that would lead to questioning whether an entity is complying with laws and regulations. … [T]he auditor should obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry and how the entity is complying with that framework. … [T]he auditor should perform procedures to help identify instances of non-compliance with those laws and regulations where non-compliance should be considered when preparing financial statements …' In this regard, the effect of non-compliance with laws and/or regulations on contingent liabilities should not be overlooked.
2.16	In the absence of a duty under regulated industry requirements, to report privately to an appropriate authority such as the Police or Department of Trade and Industry, if during the audit it is discovered that illegal acts have been committed by the organisation's management or directors	**SAS 120.13, 15:** 'Where the auditors become aware of a suspected or actual instance of non-compliance with law or regulations which does not give rise to a statutory duty to report to an appropriate authority they should (a) consider whether the matter may be one that ought to be reported to a proper authority in the public interest; and where this is the case (b) except in the circumstances covered in SAS 120.15, discuss the matter with the board of directors, including an audit committee. Auditors should report a matter direct to a proper authority in the public interest and without discussing the matter with the entity if they conclude that the suspected or actual instance of non-compliance has caused them no longer to have confidence in the integrity of the directors'. It is submitted that where illegal acts have been committed by the organisation's senior officers, it is a matter that 'ought to be reported to a proper authority in the public interest'.

2.26b	To examine the organisation's entire annual report (the report containing or accompanying its financial statements) and report (in the published auditor's report) only on information within the annual report which is inconsistent with the financial statements	**Companies Act 1985 s235(3):** 'The auditors shall consider whether the information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with those accounts; and if they are of opinion that it is not they shall state that fact in their report'. **SAS 160. 2-3:** 'If auditors identify an inconsistency between the financial statements and the other information [in the annual report], or a misstatement within the other information, they should consider whether an amendment is required to the financial statements or to the other information and should seek to resolve the matter through discussion with the directors. If, after discussion with the directors, the auditors conclude that the financial statements require amendment and so such amendment is made, they should consider the implications for their report. If, after discussion with the directors, the auditors conclude that the other information requires amendment and no such amendment is made, they should consider appropriate action'. **ISA 720 para 11-13:** 'If on reading the other information, the auditor identifies a material inconsistency, the auditor should determine whether the audited financial statements or the other information needs to be amended. If an amendment is necessary in the audited financial statements and the entity refuses to made the amendment, the auditor should express a qualified or adverse opinion. If an amendment is necessary in the other information and the entity refuses to made the amendment, the auditor should consider including in the auditor's report an emphasis of matter paragraph describing the material inconsistency or taking other actions'.
2.27bii	In the case of a listed company, to examine its compliance with a limited (specified) set of the Stock Exchange's governance requirements and to report (in the published auditor's report) only instances of non-compliance	**Auditing Practices Board Bulletin 1999/5 para 6, 19-21:** The Stock Exchange Listing Rule 12.43A(b) requires companies to make a statement in the annual report and accounts as to whether or not they have complied throughout the accounting period with the 'Code provisions' in section 1 of the Combined Code. Listing Rule 12.43A also requires auditors to review the company's statement before publication, but only insofar as it relates to Code provisions A.1.2, A.1.3, A.6.1, A.6.2, D.1.1, D.2.1, and D.3.1. 'Where the auditors become aware of any Code provision with which the company has not complied, and that is within the scope of their review, they satisfy themselves that the departure is described in the directors' statement of compliance. Where there is a departure from a Code provision specified for the auditors' review but there is proper disclosure of this fact and of the reasons for the departure, as envisaged by Listing Rule 12.43A(b), the auditors do not report this in their report on the financial statements. However, where the auditors consider that there is not proper disclosure of a departure from a Code provision specified for their review the auditors report this in the opinion section of their report on the financial statements'.

Responsibilities classified as non-responsibilities of auditors that were particularly open to interpretation (see endnote 1)

2.12c	To disclose the fact in the published auditor's report if during the audit it is discovered that the organisation's directors or senior management have embezzled organisational assets	**SAS 110.8, 9:** 'Where the auditors conclude that the view given by the financial statements could be affected by a level of uncertainty concerning the consequences of a suspected or actual error or fraud which, in their opinion, is fundamental, they should include an explanatory paragraph referring to the matter in their report. Where the auditors conclude that a suspected or actual instance of fraud or error has a material effect on the financial statements and they disagree with the accounting treatment or with the extent, or lack, of disclosure in the financial statements of the instance or of its consequences they should issue an adverse or qualified opinion. If the auditors are unable to determine whether fraud or error has occurred because of limitation in the scope of their work, they should issue a disclaimer or a qualified opinion'.
2.12 (Cont)		**ISA 240 para 21-22:** 'If the auditor concludes that the fraud or error has a material effect on the financial statements and has not been properly reflected or corrected in the financial statements, the auditor should express a qualified or adverse opinion. If the auditor is precluded by the entity from obtaining sufficient appropriate audit evidence to evaluate whether fraud or error that may be material to the financial statements, has, or is likely to have, occurred, the auditor should express a qualified opinion or a disclaimer of opinion on the financial statements on the basis of a limitation on the scope of the audit'. **Companies Act 1985 s.237(2), (3):** See above. These subsections may be relevant if the directors or senior management have failed to maintain proper accounting records and/or withheld information or explanations from the auditors in an attempt to cover up their embezzlement.

2.15a	To disclose in the published auditor's report illegal acts committed by the organisation's management or directors which are discovered during the audit which directly impact on the organisation's financial statements (such as bribery and political payoffs)	**SAS 120.10, 11**: 'Where the auditors conclude that the view given by the financial statements could be affected by a level of uncertainty concerning the consequences of a suspected or actual non-compliance [with law or regulations] which, in their opinion, is fundamental, they should include an explanatory paragraph referring to the matter in their report. Where the auditors conclude that a suspected or actual instance of non-compliance with law or regulation has a material effect on the financial statements and they disagree with the accounting treatment or with the extent , or lack, of any disclosure in the financial statements of the instance or of its consequences they should issue an adverse or qualified opinion. If the auditors are unable to determine whether non-compliance with law or regulations has occurred because of limitation in the scope of their work, they should issue a disclaimer or a qualified opinion'. **ISA 250 para 32-33:** 'If the auditor concludes that the non-compliance [with law or regulations] has a material effect on the financial statements, and has not been properly reflected in the financial statements, the auditor should express a qualified or an adverse opinion. If the auditor is precluded by the entity from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements, has, or is likely to have, occurred, the auditor should express a qualified opinion or a disclaimer of opinion on the financial statements on the basis of a limitation on the scope of the audit'.
2.17d	To examine and report (in the published auditor's report) on the fairness (reliability) of information contained in in the organisation's annual report about the organisation's directors' and senior executives' remuneration policy and record	**Auditing Practices Board Bulletin 1999/5, para 57-59:** 'Under Listing Rule 12.43A(c) the boards of listed companies are required … to (a) make a report to shareholders on directors' remuneration which contains a statement of the company's policy on executive directors' remuneration and (b) within that report disclose the amount of each element in the remuneration package of each director by name … Listing Rule 12.43A also requires that the scope of the auditors' report on the financial statements cover the disclosures relating to each named director … Compliance with Listing Rule 12.43A(c) is intended to ensure compliance with Schedule 6 to the Companies Act 1985'

Endnotes:

1 Responsibilities 2.17d, 2.12c and 2.15a as presented in the questionnaire were particularly open to interpretation. The responses of a control group of six leading auditing professionals, who could be expected to be particularly knowledgeable about auditors' responsibilities under the law, Auditing Standards and regulations, have been taken to indicate how knowledgeable respondents interpreted the suggested responsibilities in the questionnaire.

2 Statement of Auditing Standard. In all cases where the related ISA is quoted above, the SAS states 'Compliance with this SAS ensures compliance in all material respects with [the relevant] International Standard on Auditing'.

3 International Standards on Auditing.

Appendix C

Ascertaining the 'Knowledge Gap' of Auditors' Interest Groups in the UK

Respon No.	Interest Group	Auditors	Auditees	Audit Beneficiaries: Financial Community	Audit Beneficiaries: Non-Fin Community
	No of respondents in group	*146*	*101*	*106*	*72*
	Suggested responsibilities of auditors[1]	%[2]	%[2]	%[2]	%[2]
2.1	Prepare the auditee's financial statements	1	7	37	41
2.2	Guarantee the auditee's financial statements are accurate	1	11	22	67
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	3	4	4	13
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	5	16	31	56
2.5a	Report to an appropriate authority (*eg* DTI or FSA) doubts about the auditee's continued existence	19	35	40	67
2.5b	Disclose in the audit report doubts about the auditee's continued existence	6	18	20	37
2.6	Ensure compliance with relevant legislation	13	17	39	26
2.7	Report breaches of tax law to the Inland Revenue	9	29	52	65
2.8a	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by non-managerial employees	53	59	67	40
2.8b	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by directors/senior management	53	56	56	32
2.9a	**Detect minor (but not petty) theft of auditee's assets by non-managerial employees**	1	10	25	60
2.9b	**Detect minor (but not petty) theft of the auditee's assets by directors/senior management**	1	14	31	64
2.10	Detect deliberate distortion of the auditee's financial statements	23	13	18	8
2.11a	**In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), minor (but not petty) theft of the auditee's assets by non-managerial employees**	1	9	27	43
2.11b	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), theft of material amount of the auditee's assets by non-managerial employees	10	16	45	63
2.11c	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), embezzlement of the auditee's assets by directors/senior management	70	58	51	35

2.11d	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI), deliberate distortion of the auditee's financial statements	21	56	67	83
2.12a	**Disclose in the audit report minor (but not petty) theft of the auditee's assets by non-managerial employees**	1	11	26	54
2.12b	Disclose in the audit report theft of a material amount of the auditee's assets by non-managerial employees	23	45	54	73
2.12c	Disclose in the audit report embezzlement of the auditee's assets by its directors/senior management	34	67	74	81
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	22	22	35	26
2.13	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) suspicions of theft or deliberate distortion of the auditee's financial statements	14	29	54	71
2.14a	Detect illegal acts by the auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	58	47	62	30
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	17	22	34	41
2.15a	Disclose in the audit report illegal acts by the auditee's officials which directly impact on the auditee's financial statements	35	60	65	80
2.15b	Disclose in the audit report illegal acts by the auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	11	28	39	51
2.16	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or DTI) illegal acts committed by the auditee's officials	78	75	75	61
2.17a	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its equal employment opportunities policy and record	7	17	24	35
2.17b	**Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its product safety policy and record**	4	14	21	33
2.17c	**Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its occupational health and safety policy and record**	4	16	22	34
2.17d	**Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors/senior executives' remuneration policy and record**	55	57	55	75
2.18a	Examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls	27	70	58	86
2.18b	**Examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls**	10	46	23	43

2.19	*Examine and report (in the audit report) on auditee's IT systems*	3	25	25	39
2.20	*Examine and report (in the audit report) on the auditee's non-financial performance*	2	7	16	21
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of the auditee's management and administration	0	15	13	35
2.22a	Audit half-yearly published financial statements	9	22	23	66
2.22b	*Audit quarterly published financial statements*	2	15	14	51
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in the auditee's annual report	9	38	30	68
2.24a	Consider and report (in audit report) on the impact of the auditee on its local community	0	5	8	24
2.24b	*Consider and report (in the audit report) on the impact of the auditee on its environment*	0	6	10	22
2.25	Verify every transaction of the auditee	0	2	11	36
2.26a	*Examine and report (in the audit report) on the reliability of information in the auditee's entire annual report*	9	32	39	60
2.26b	*Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements*	10	42	62	56
2.27ai	*For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) on compliance therewith*	23	55	49	81
2.27aii	*For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance*	32	50	50	57
2.27bi	*For listed company auditees, examine compliance with a specified set of Stock Exchange's governance requirements and report (in the audit report) on compliance therewith*	37	46	56	80
2.27bii	*For listed company auditees, examine compliance with a specified set of Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance*	55	80	80	90
2.28	*Examine and report to the auditee's directors (or equivalent) on the adequacy of the auditee's risk management procedures*	35	51	60	73
2.29	*Examine and report (in the audit report) on the adequacy of the auditee's risk management procedures*	4	30	29	61
2.30	*Examine and report (in attached audit report) on reliability of the auditee's financial information on the Internet*	5	26	26	69
	Measure of 'total knowledge gap'	925	1601	1954	2663
	Measure of average 'knowledge gap' per duty	18	31	38	52
	Group's contribution to total 'knowledge gap'	13%	23%	27%	37%

1. The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.

2. Percentage of respondents selecting either the 'not sure' or the incorrect option ('yes' for responsibilities which are not responsibilities of auditors and 'no' for those which are).

Appendix D

Ascertaining the 'knowledge gap' of auditors' interest groups in NZ

Resp No.	Interest Group	Auditors	Auditees	Audit Beneficiaries: Financial Community	Audit Beneficiaries: Non-Fin Community
	No of respondents in group	*70*	*152*	*106*	*171*
	Suggested responsibilities of auditors[1]	%[2]	%[2]	%[2]	%[2]
2.1	Prepare the auditee's financial statements	3	7	14	30
2.2	Guarantee the auditee's financial statements are accurate	6	10	34	63
2.3	State whether the auditee's financial statements fairly reflect its financial affairs	0	4	6	20
2.4	Guarantee auditee (with 'clean' audit report) is financially sound	4	18	36	61
2.5a	Report to an appropriate authority (*eg* Registrar of Cos or Reserve Bank) doubts about the auditee's continued existence	31	26	47	67
2.5b	Disclose in the audit report doubts about the auditee's continued existence	13	17	17	41
2.6	Ensure compliance with relevant legislation	26	27	24	39
2.7	Report breaches of tax law to the Inland Revenue	12	10	24	63
2.8a	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by non-managerial employees	46	51	45	39
2.8b	Detect theft of a material amount (*eg* > 5% of turnover or total assets) of the auditee's assets by directors/senior management	46	49	41	36
2.9a	Detect minor (but not petty) theft of the auditee's assets by non-managerial employees	3	14	35	69
2.9b	Detect minor (but not petty) theft of the auditee's assets by directors/senior management	3	18	41	70
2.10	Detect deliberate distortion of the auditee's financial statements	29	7	14	16
2.11a	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos), minor (but not petty) theft of the auditee's assets by non-managerial employees	4	11	31	63
2.11b	In the absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos), theft of material amount of the auditee's assets by non-managerial employees	13	22	52	74

2.11c	In the absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos), embezzlement of auditee assets by the directors/senior management	33	49	66	83
2.11d	In the absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos), deliberate distortion of the auditee's financial statements	25	45	68	83
2.12a	Disclose in the audit report minor (but not petty) theft of the auditee's assets by non-managerial employees	0	11	33	69
2.12b	Disclose in the audit report theft of a material amount of the auditee's assets by non-managerial employees	20	41	64	84
2.12c	Disclose in the audit report embezzlement of auditee assets by the directors/senior management	37	61	65	89
2.12d	Disclose in the audit report deliberate distortion of the auditee's financial statements	27	15	33	40
2.13	In the absence of a regulated industry duty, report to an appropriate authority (*eg* Police or Registrar of Cos) suspicions of theft or deliberate distortion of the auditee's financial statements	15	25	51	75
2.14a	Detect illegal acts by the auditee's officials which directly impact on the auditee's financial statements (*eg* political payoffs)	56	43	43	41
2.14b	Detect illegal acts by auditee's officials which only indirectly impact on the auditee's financial statements (*eg* breaches of environmental laws and regulations)	14	27	47	62
2.15a	Disclose in the audit report illegal acts by the auditee's officials which directly impact on the auditee's financial statements	33	59	56	89
2.15b	Disclose in the audit report illegal acts by the auditee's officials which only indirectly impact on the organisation's financial statements (*eg* breaches of environmental laws)	10	24	39	67
2.16	In the absence of a regulated industry duty, to report to an appropriate authority (*eg* Police or Registrar of Cos) illegal acts committed by the auditee's officials	26	34	51	75
2.17a	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its equal employment opportunities policy and record	3	13	20	43
2.17b	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its product safety policy and record	4	14	23	44
2.17c	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its occupational health and safety policy and record	4	15	23	43
2.17d	Examine and report (in the audit report) on the reliability of information in the auditee's annual report about its directors/senior executives' remuneration policy and record	19	38	48	64

2.18a	Examine and report (in the audit report) on the effectiveness of the auditee's internal financial controls	43	74	74	92
2.18b	Examine and report (in the audit report) on the effectiveness of the auditee's internal non-financial controls	17	37	43	54
2.19	Examine and report (in the audit report) on auditee's IT systems	13	24	35	48
2.20	Examine and report (in the audit report) on the auditee's non-financial performance	10	19	26	38
2.21	Examine and report (in the audit report) on the efficiency and effectiveness of the auditee's management and administration	4	16	34	48
2.22a	Audit half-yearly published financial statements	32	33	48	74
2.22b	Audit quarterly published financial statements	22	18	32	64
2.23	Examine and report (in the audit report) on the reasonableness of financial forecasts included in the auditee's annual report	25	38	49	70
2.24a	Consider and report (in audit report) on the impact of the auditee on its local community	4	5	15	37
2.24b	Consider and report (in the audit report) on the impact of the auditee on its environment	4	5	15	37
2.25	Verify every transaction of the auditee	3	4	15	49
2.26a	Examine and report (in the audit report) on the reliability of information in the auditee's entire annual report	17	24	58	70
2.26b	Examine and report (in the audit report) on information in the auditee's annual report which is inconsistent with its financial statements	60	52	67	61
2.27a	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) on compliance therewith	23	40	47	82
2.27b	For listed company auditees, examine compliance with all Stock Exchange's governance requirements and report (in the audit report) instances of non-compliance	27	40	38	72
2.28	Examine and report privately to the auditee's directors on the adequacy of its risk management procedures	59	63	69	75
2.29	Examine and report (in the audit report) on the adequacy of the auditee's risk management procedures	9	22	38	66
2.30	Examine and report (in attached audit report) on reliability of the auditee's financial information on the Internet	19	23	36	69
	Measure of 'total knowledge gap'	956	1342	1930	2908
	Measure of average 'knowledge gap' per duty	20	27	39	59
	Group's contribution to total 'knowledge gap'	13%	19%	27%	41%

[1] The suggested responsibilities as shown here are abbreviated from their expression in the questionnaire.

[2] Percentage of respondents selecting either the 'not sure' or the incorrect option ('yes' for responsibilities which are not responsibilities of auditors and 'no' for those which are).

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